Morgan Stanley

MORGAN STANLEY RESEARCH

October 19, 2011

North America

# 20 for 2015

**Amid the last financial crisis, we published '50 for 2012' and '30 for 2013', in which we identified companies likely to strengthen and extend their sustainable competitive advantages as conditions stabilized. We revisit this project with '20 for 2015': Stocks for a three-year holding period.**

***20 for 2015* identifies our best long term picks based on sustainability and quality of business model**. This new piece follows the *50 for 2012* and the *30 for 2013* reports series, whereby we ask our analysts to identify the highest-quality companies in their sectors at times of market dislocations. We strongly believe that those times provided excellent opportunities to look at companies with sustainable competitive advantages which are likely to emerge with an even more powerful edge when markets and economies stabilize.

**The main criterion is sustainability —** of competitive advantages, business model, pricing power, cost efficiency and growth. We selected the companies that scored best on these criteria and we paid special attention to RNOA as the key metric that reflects the aforementioned attributes. We are purposely ignoring management's attitude toward capital structure, as most companies on the list are expected to generate significant FCF that will accumulate on the balance sheet, artificially depressing ROEs. Managers will have the choice to redeploy that capital into the business more aggressively or return it to shareholders. We limited the list to 20 companies; we also highlight 20 runners-up that were close contenders.

**We are taking a long term view.** We have tried to identify the best franchises, not the most undervalued stocks. There was no prerequisite in our analysis that they be rated Overweight, nor specific assumptions about were we are in the economic cycle or any other valuation considerations. Our driving principle was to create a list of companies whose business models and market positions would be increasingly differentiated by 2015.

CVX, SLB, TGT, UNP and UTX are also in the top 2 quintiles in BEST, Adam Parker's systematic stock-selection (alpha) model with a 24-month horizon.

**Amazon.com***
**BorgWarner***
**Chevron**
**Cognizant Tech. Solutions**
**Colgate-Palmolive**
**Dollar Tree**
**Enterprise Products Partners**
**Essex Property Trust**
**IHS Inc.**
**Oracle**
**Philip Morris International**
**Qualcomm**
**RenaissanceRe***
**Schlumberger***
**Target***
**Teradata***
**Union Pacific***
**United Technologies**
**VF Corp.**
**Visa**

*** On Morgan Stanley's US Best Ideas list**

*Morgan Stanley's 20 for 2015 basket can be found on Bloomberg: MSMS2015 <Index>.*

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# '20 for 2015' Poll

## Analyst Impressions

Weaker → Stronger

| | Market Share Growth | Multiple Market Share Drivers | Resilience to Current Head-winds | Pricing Power | Cost Efficiency | Benefits from Scale | Operational Leverage | Multiple Drivers of ROE | Mgmt's Strategic Thinking | Capital Allocation | Corporate Governance | Page |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Amazon.com** (AMZN, $246.71) | ● | ● | ● | ◐ | ◐ | ● | ◕ | ◐ | ● | ● | ● | 5 |
| **BorgWarner** (BWA, $70.86) | ● | ◕ | ◕ | ◕ | ◕ | ◕ | ◐ | ◕ | ● | ◕ | ● | 6 |
| **Chevron** (CVX, $100.47) | ◕ | ◕ | ● | ◕ | ◕ | ◕ | ◕ | ◔ | ● | ● | ● | 7 |
| **Cognizant Tech. Solutions** (CTSH, $72.22) | ● | ● | ● | ● | ◔ | ◕ | ◐ | ◔ | ● | ◐ | ◕ | 8 |
| **Colgate-Palmolive** (CL, $92.34) | ◕ | ◔ | ◕ | ● | ● | ◕ | ◕ | ◕ | ● | ● | ● | 9 |
| **Dollar Tree** (DLTR, $80.26) | ◕ | ◔ | ◕ | ◕ | ◐ | ◕ | ◕ | ◕ | ◕ | ● | ● | 10 |
| **Enterprise Products Ptnrs.** (EPD, $43.23) | ● | ◔ | ● | ● | ◐ | ● | ◕ | ◐ | ● | ● | ● | 11 |
| **Essex Property Trust** (ESS, $128.39) | ◕ | ◔ | ◕ | ◕ | ◐ | ◕ | ◕ | ◕ | ◕ | ● | ● | 12 |
| **IHS Inc.** (IHS, $79.29) | ● | ◕ | ◕ | ● | ● | ● | ● | ◔ | ◕ | ◕ | ◕ | 13 |
| **Oracle** (ORCL, $31.85) | ◕ | ◕ | ◕ | ◕ | ◕ | ● | ◕ | ◕ | ● | ◕ | ◕ | 14 |
| **Philip Morris Internat'l** (PM, $67.40) | ◕ | ◕ | ◐ | ◕ | ● | ● | ◕ | ◐ | ◕ | ● | ● | 15 |
| **Qualcomm** (QCOM, $54.98) | ● | ● | ◐ | ◕ | ◕ | ● | ● | ◔ | ● | ◐ | ● | 16 |
| **RenaissanceRe** (RNR, $63.00) | ● | ◐ | ● | ● | ◐ | ◕ | ● | ◐ | ● | ● | ◕ | 17 |
| **Schlumberger** (SLB, $70.94) | ◕ | ◕ | ● | ● | ◐ | ◕ | ◐ | ◕ | ● | ● | ◕ | 18 |
| **Target** (TGT, $52.95) | ◕ | ● | ◐ | ◕ | ◕ | ◐ | ◕ | ◐ | ● | ◕ | ◕ | 19 |
| **Teradata** (TDC, $59.31) | ◕ | ◐ | ● | ◐ | ◕ | ◕ | ◕ | ◐ | ● | ● | ● | 20 |
| **Union Pacific** (UNP, $91.97) | ◕ | ◔ | ◕ | ● | ◕ | ● | ◕ | ◐ | ● | ● | ● | 21 |
| **United Technologies** (UTX, $74.64) | ● | ● | ● | ◕ | ● | ● | ◕ | ◕ | ● | ● | ● | 22 |
| **VF Corp.** (VFC, $133.95) | ◕ | ◐ | ◕ | ◐ | ◕ | ● | ◕ | ◕ | ● | ● | ● | 23 |
| **Visa** (V, $93.92) | ● | ◔ | ● | ● | ◐ | ● | ◕ | ◐ | ● | ● | ● | 24 |
| | Market Share Growth | Multiple Market Share Drivers | Resilience to Current Head-winds | Pricing Power | Cost Efficiency | Benefits from Scale | Operational Leverage | Multiple Drivers of ROE | Mgmt's Strategic Thinking | Capital Allocation | Corporate Governance | Page |

*All share prices in this report are October 14, 2011, closing prices.*

# '20 for 2015'

| Financial Metrics | Revenue 5-Yr CAGR ('10-15e) | EPS 5-Yr CAGR ('10-15e) | EBIT Margin 2012e | EBIT Margin 2015e | RNOA 2012e | RNOA 2015e | Net Debt/ EBITDA 2011e | Interest Cover 2011e |
|---|---|---|---|---|---|---|---|---|
| Amazon.com | 30% | 29% | 3% | 5% | NM | NM | NM | NM |
| BorgWarner | 16% | 20% | 12% | 11% | 22% | 24% | 0.2x | 14.1x |
| Chevron | 10% | 10% | 13% | 14% | 26% | 21% | NM | NM |
| Cognizant Tech. Solutions | 21% | 17% | 18% | 18% | 68% | 63% | NM | NM |
| Colgate-Palmolive | 5% | 8% | 24% | 26% | 40% | 46% | 1.0x | 54.9x |
| Dollar Tree | 10% | 17% | 13% | 14% | 23% | 27% | 1.0x | NM |
| Enterprise Products Partners | 11% | 6% | 6% | 6% | 11% | 11% | 4.2x | 3.5x |
| Essex Property Trust | 5% | NM | 35% | 43% | NM | NM | 8.5x | 1.5x |
| IHS Inc. | 13% | 23% | 20% | 27% | 12% | 26% | 1.7x | 18.9x |
| Oracle | 8% | 11% | 46% | 49% | 37% | 50% | NM | 27.6x |
| Philip Morris International | 5% | 12% | 44% | 47% | 42% | 55% | 1.2x | 15.5x |
| Qualcomm | 15% | 14% | 39% | 41% | 90% | 97% | NM | NM |
| RenaissanceRe | NA | 8% | NM | NM | NM | NM | NM | NM |
| Schlumberger | 23% | 27% | 21% | 21% | 17% | 21% | 0.6x | 28.3x |
| Target | 5% | 11% | 7% | 8% | 9% | 15% | 2.6x | 6.8x |
| Teradata | 13% | 16% | 23% | 25% | 41% | 50% | NM | NM |
| Union Pacific | 8% | 16% | 33% | 36% | 14% | 16% | 1.5x | 10.8x |
| United Technologies | 8% | 13% | 14% | 17% | 20% | 17% | 0.9x | 13.8x |
| VF Corp. | 13% | 16% | 14% | 15% | 16% | 22% | 1.5x | 17.5x |
| Visa | 10% | 14% | 60% | 61% | 17% | 23% | NM | NM |

Source: Morgan Stanley Research estimates  Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

| Valuation Metrics | P/E 2012e | EV/EBIT 2012e | FCF Yld 2012e | Div Yld 2012e | % 12-18 month upside/downside to Base | Bull | Bear |
|---|---|---|---|---|---|---|---|
| Amazon.com | 54.8x | 46.8x | 2.0% | 0.0% | 11% | 40% | -35% |
| BorgWarner | 12.4x | 8.2x | 1.3% | 0.0% | 24% | 41% | -29% |
| Chevron | 8.7x | 4.2x | 5.3% | 3.3% | 36% | 61% | -13% |
| Cognizant Tech. Solutions | 21.6x | 13.8x | 3.2% | 0.0% | 2% | 14% | -45% |
| Colgate-Palmolive | 16.6x | 11.3x | 5.7% | 2.7% | 9% | 20% | -18% |
| Dollar Tree | 17.1x | 11.4x | 5.7% | 0.0% | 7% | 25% | -25% |
| Enterprise Products Partners | 18.2x | 17.9x | 7.6% | 5.9% | 6% | 16% | -17% |
| Essex Property Trust | NM | NM | NM | 3.5% | 27% | 36% | -13% |
| IHS Inc. | 19.0x | 17.6x | 6.4% | 0.0% | 21% | 59% | -22% |
| Oracle | 11.6x | 6.5x | 8.7% | 0.8% | 13% | 38% | -37% |
| Philip Morris International | 13.2x | 9.5x | 8.1% | 4.9% | 11% | 35% | -18% |
| Qualcomm | 15.5x | 10.4x | 5.5% | 0.4% | 4% | 31% | -35% |
| RenaissanceRe | 6.2x | NM | NM | 1.7% | 38% | 59% | -5% |
| Schlumberger | 13.5x | 10.5x | 4.1% | 1.6% | 48% | 126% | -35% |
| Target | 12.6x | 9.7x | 7.0% | 2.4% | 21% | 44% | -24% |
| Teradata | 23.3x | 15.5x | 3.6% | 0.0% | 10% | 37% | -26% |
| Union Pacific | 11.8x | 7.9x | 5.7% | 2.4% | 14% | 23% | -17% |
| United Technologies | 12.4x | 9.8x | 9.6% | 2.9% | 27% | 47% | -20% |
| VF Corp. | 14.6x | 10.9x | 5.7% | 2.0% | 12% | 37% | -47% |
| Visa | 16.9x | 8.1x | 5.8% | 0.9% | 12% | 60% | -25% |

Source: Morgan Stanley Research estimates  Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

# The Runners-Up

In assembling our 20 for 2015, we polled all of our US analysts, asking them to submit their highest-conviction ideas for a three-year holding period — the highest quality companies in their sectors. The response was strong — 46 stocks.

In selecting the 20 most outstanding opportunities from among these candidates, we considered the analyst's scores and the input from Morgan Stanley's Stock Selection Committee as well as Research management. The selection of only 20 was a difficult task, and the committee's debate was vigorous.

Many outstanding companies with a compelling long-term outlook but with a slightly less attractive investment case were left off our list. Like the 20 for 2015, they also feature (1) high analyst conviction; (2) sustainable competitive advantages and a robust business model, and (3) profitability.

The "runners-up" are:

**Accenture** (ACN, $58.80)
**American Tower** (AMT, $55.83)
**Apple** (AAPL, $422.00)
**Booz Allen & Hamilton** (BAH, $16.50)
**Coach Inc** (COH, $62.08)
**Costco Wholesale** (COST, $81.77)
**Crown Castle International** (CCI, $43.32)
**eBay** (EBAY, $33.69)
**Fifth Third Bancorp** (FITB, $11.34)
**Grifols** (GRFS, $6.67)
**Host Hotels & Resorts** (HST, $12.37)
**IBM** (IBM, $190.53)
**Las Vegas Sands** (LVS, $45.25)
**Limited Brands** (LTD, $42.66)
**Macy's** (M, $29.26)
**MasterCard** (MA, $341.58)
**Rackspace Hosting** (RAX, $39.96)
**Rogers Communications** (RCIb.TO, C$35.79)
**Solazyme** (SZYM, $9.84)
**UnitedHealth** Group (UNH, $47.22)

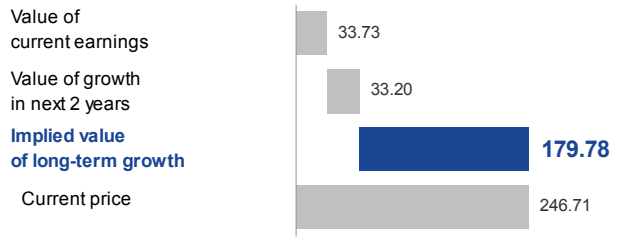
## Consumer Discretionary

MORGAN STANLEY
BEST IDEA

# Amazon.com (AMZN)

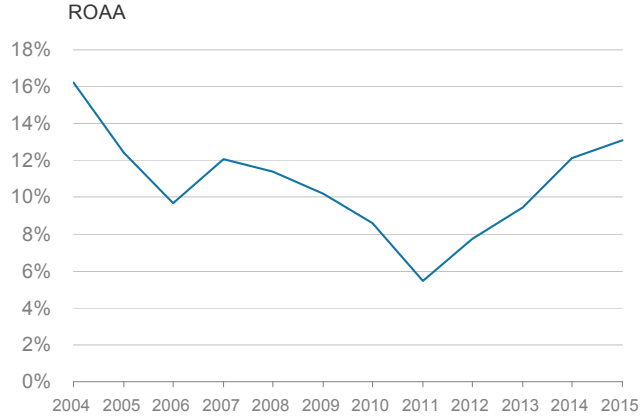
Morgan Stanley & Co. LLC **Scott Devitt**

### Value of Growth




Cost of Equity uses 5-yr beta, Rf of 4% and MRP of 4%

### Return on Average Assets*




* Operating Income (GAAP EBIT) / Average Total Assets

**Amazon.com vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | Amazon.com percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | | | 52.5% | 15.4% |
| Sales '11-'13 CAGR | | | | | | 31.1% | 18.6% |
| **Returns** | | | | | | | |
| RNOA | | | | | | | |
| EBIT margin | 3.3% | | | | | | 12.2% |
| **Valuation** | | | | | | | |
| P/E | | | | | | 54.8x | 20.4x |
| EV/Ebit | | | | | | 46.8x | 14.2x |
| P/FCF | | | | | 49.3x | | 26.8x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | | | | |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.
For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

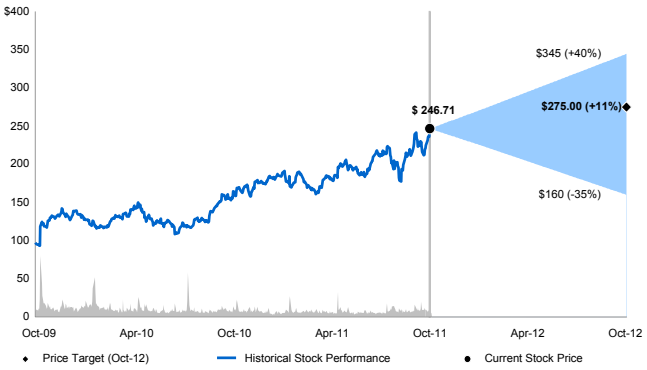
Internet Industry View: Attractive

**We believe Amazon.com is best positioned to lead the continuing secular transition from traditional retail to offline eCommerce.** We believe Amazon.com is unique from other large-cap companies in traditional retail because of its long-term vision of creating a customer-centric user experience. On multiple occasions, at different points in the company's life-cycle, Amazon.com has chosen to innovate, oftentimes cannibalizing existing business platforms in order to better position itself to provide its customers the products they will want.

Amazon.com invests gross profit dollars into lower sales prices of merchandise to take market share in traditional retail categories. Over the next 5 years, we are looking for 30% annualized sales growth. We have high conviction that Amazon.com can maintain growth at this level by increasing the number of its Amazon Prime accounts. Amazon Prime allows customers to pay an annual subscription fee of $79 (a prime number) in exchange for free 2-day domestic shipping (ship times vary by country), 1-day shipping for an additional $3.99 per item; and free, unlimited access to Prime Instant Videos (a video streaming service that offers a variety of full-length feature films and TV shows from major film studios).

Amazon.com aims to increase the number of Prime subscribers through its Kindle Fire and the content ecosystem that is built around the tablet. The streaming video is a growing piece of the Fire's content ecosystem, and we believe Fire owners will be predisposed to subscribing to Prime, which implies a $6.58 per month price point for the streaming video content. We estimate that Prime customers are worth between 2x and 4x the customer lifetime value of a non-Prime customer.

### Risk Reward on a 12-mth view (Overweight, PT $275)



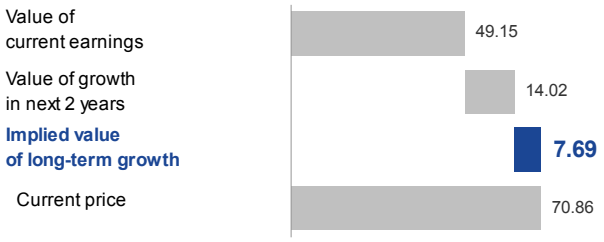
## Consumer Discretionary

MORGAN STANLEY
BEST IDEA

# BorgWarner (BWA)

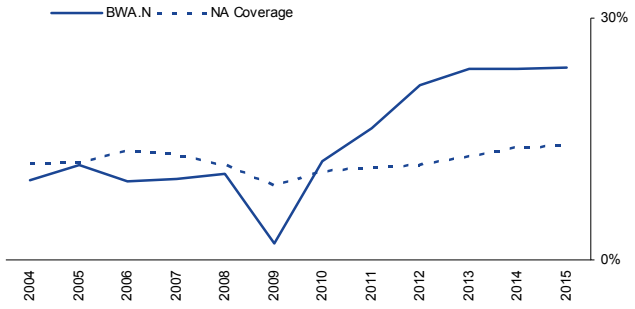
Morgan Stanley & Co. LLC **Ravi Shanker**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**BorgWarner Inc. vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | BorgWarner Inc. percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | 23.4% | | | 22.4% |
| Sales '11-'13 CAGR | | | | | | 16.1% | 9.9% |
| **Returns** | | | | | | | |
| RNOA | | | | | 21.6% | | 17.6% |
| EBIT margin | | | | | | 12.0% | 6.4% |
| **Valuation** | | | | | | | |
| P/E | | | | | | 12.4x | 7.8x |
| EV/Ebit | | | | | 8.2x | | 6.2x |
| P/FCF | | | | | 18.8x | | 14.7x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | 0.2x | | | | | | 1.9x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Autos & Auto-Related Industry View: Attractive

**We see BorgWarner as the most powerful secular story in the group over the next decade**, one that should drive an 18-20% revenue CAGR (approximately four times the industry growth rate) and class-leading margins. We believe the market significantly underestimates the growth potential, especially in end-markets outside of light vehicle turbo.

We expect the main drivers of outsize top-line growth at BorgWarner to include:

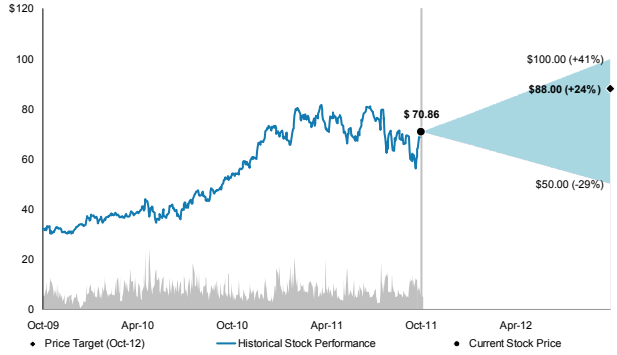
(1) *Content growth: OEMs must improve fuel economy by 20% by 2016 and an additional 50% by 2025.* We see turbo/dual clutch transmission as the closest thing the industry has to a silver bullet for compliance. BorgWarner is more than just turbo, however, with demand for its other emissions/fuel economy-related technology growing just as quickly.

(2) *Commercial vehicles (CV) are rarely associated with BorgWarner, despite being ~15% of revenues.* Cyclical recovery in 2011/12, new fuel economy regulations, and BorgWarner's growing presence in hot-end emissions, could make CV a material driver of earnings.

(3) *China exposure could double in three years, as it is barely 6% of revenues today but almost 20% of the backlog* as BorgWarner continues to penetrate the market and gain share.

**Sustainable competitive advantage should also drive margin gains.** BorgWarner participates in end markets that are concentrated among few players, have high barriers to entry, and could see a skewed demand-supply equation for the next several years. This should bring pricing power and consequently margins, which we expect will be well in excess of BorgWarner's historical high water marks.

**Risk-reward on a 12-mth view (Overweight, Price Target $88)**

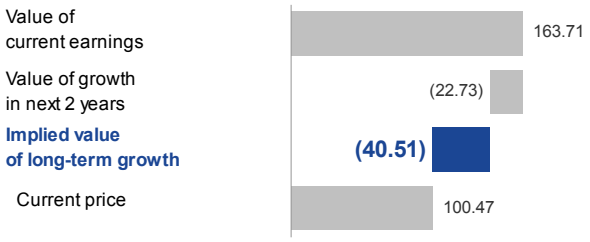


## Energy

# Chevron (CVX)

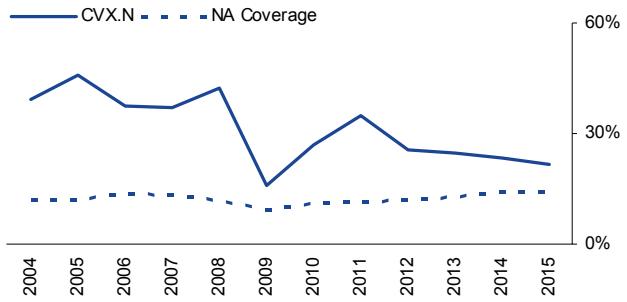
Morgan Stanley & Co. LLC **Evan Calio**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**
**Chevron Corporation vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | Chevron Corporation percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | | -1.8% | | -10.0% |
| Sales '11-'13 CAGR | | | | | | 10.2% | -7.6% |
| **Returns** | | | | | | | |
| RNOA | | | | | 25.7% | | 16.7% |
| EBIT margin | | | | | 13.3% | | 6.5% |
| **Valuation** | | | | | | | |
| P/E | | | | | 8.7x | | 7.9x |
| EV/Ebit | | | | 4.2x | | | 4.5x |
| P/FCF | | | | | 18.7x | | 15.4x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | | | | 0.4x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

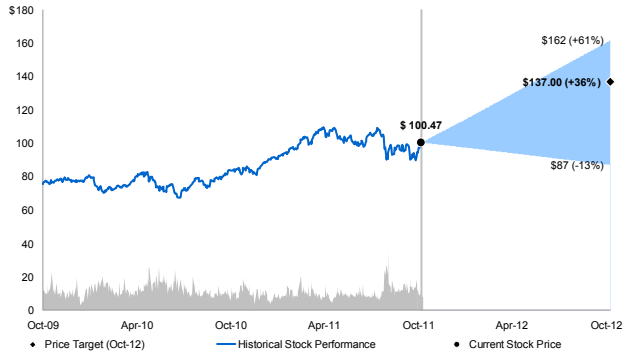
Integrated Oil Industry View: Attractive

**Chevron has improved its operational position yet the stock trades at the lowest valuation among the Integrateds** in our coverage universe. Through successful execution of mega-projects, Chevron generates the highest net income per barrel produced versus peers. Also, Chevron maintains high crude leverage, with 69% of production from oil vs. 53% average for Super Major peers (increasing in 2015), and we are more bullish on oil vs. gas prices in the medium term. Despite increasing its ROCE to 21% and above all peers except ExxonMobil, CVX trades at a discount to peer average and 25% discount to XOM. We believe the discount will materially narrow through the forecast period, especially in light CVX's 3.1% dividend yield and strongest balance sheet (net cash) among the Integrated Oils we cover.

**Accelerating production growth through 2015 should remove CVX's relative discount and grow earnings faster than peers.** We believe the startup of high-return mega-projects will extend Chevron's relative position and increase its valuation. From 2012-14, we expect the company to start projects in West Africa and Asia, adding 3-4% annual production growth through 2014. In 2015, we expect production growth to accelerate to over 5% with the start-up of the Gorgon LNG project in Australia and Lower Tertiary project in the Gulf of Mexico. Chevron's growth in this period compares well to peers, mainly oil-linked projects.

**Improvements to continue through the latter part of the decade.** We believe Chevron's returns can continue increasing by expanding mega-projects post-2015 with lower maintenance capital requirements (low decline rates). We estimate Chevron has enough discovered volumes in Australia to support expansions at both Gorgon and Wheatstone LNG facilities. Moreover, returns should significantly improve once the projects initially start, with over 25% of Chevron's current capital employed tied to projects in construction. We expect CVX's FCF yield to rise from 5.6% in 2012 to 9.6% in 2015 even with a flat crude oil price.

**Risk Reward on a 12-mth view (Overweight, Price Tgt $137)**

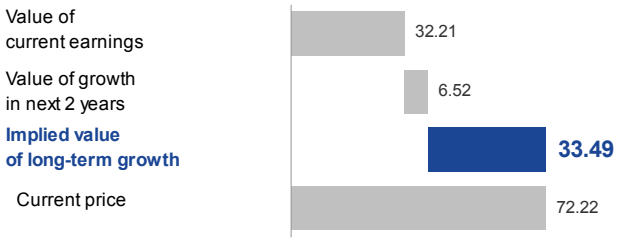


## Technology

# Cognizant Technology Solutions (CTSH)

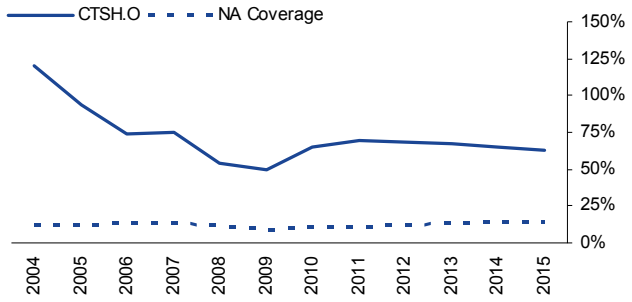
Morgan Stanley & Co. LLC Nathan Rozof, CFA

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Cognizant Technology Solutions Corp vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Cognizant Technology Solutions Corp (percentile range 0 20 40 60 80 100) | Peer median |
|---|---|---|
| **Growth** | | |
| EPS '11-'13 CAGR | 19.2% | 10.4% |
| Sales '11-'13 CAGR | 20.3% | 7.4% |
| **Returns** | | |
| RNOA | 68.4% | 46.7% |
| EBIT margin | 18.3% | 16.0% |
| **Valuation** | | |
| P/E | 21.6x | 17.1x |
| EV/Ebit | 13.8x | 11.4x |
| P/FCF | 30.9x | 16.4x |
| **Leverage** | | |
| Net Debt/Ebitda ('11) | | 1.0x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

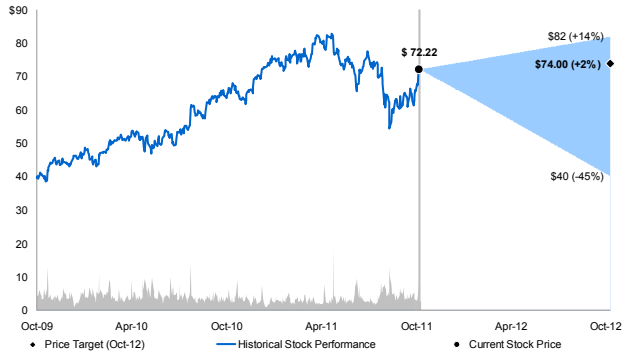
Computer Services & IT Consulting Industry View: In-Line

**Cognizant looks well positioned to benefit from the most powerful secular trends in IT services,** including the movement of work offshore, and shifting client priorities toward higher value services. Since offshore burst onto the scene in the late 1990s, Cognizant has consistently delivered double-digit growth, and we expect it to continue to do so through 2015 and beyond. Lower labor costs allow India-based companies to capture market share from US-based competitors for lower value services by competing on price (i.e. "wage arbitrage"). However, a differentiating feature for Cognizant is that it also makes significant investments in onsite employees, who provide consulting and project management services, while often simultaneously pursuing sales leads. As client needs for advice related to ramping technologies like analytics, mobility, and the cloud continue to increase, we think that Cognizant's significant onsite investments will position it well as a provider of choice for these higher value services.

We believe that Cognizant intends to transform itself from a best-in-class offshore application development and maintenance (ADM) pure play into a diversified global IT services major over time. Its strategy is three-pronged: (1) Expand the core ADM business into more industry verticals and geographies; (2) Penetrate deeper into existing clients with new service lines, like business process outsourcing (BPO), remote infrastructure, engineering, and analytics; and (3) Expand into new markets by harnessing technology waves like social networking and cloud computing. In our view, this comprehensive strategy will layer new revenue streams onto Cognizant's existing core business and will support growth over the near-, medium- and long-term.

Our Equal-weight rating (12–18-month horizon) reflects our view that the current valuation anticipates near-term upside to consensus estimates for 2011–12. However, we believe that Cognizant's secular growth characteristics and consistent execution make it an attractive candidate for investors with a longer-term view.

**Risk Reward on a 12-mth view (Equal-weight, PT $74)**

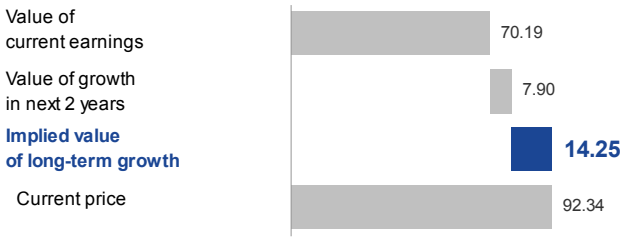


## Consumer Staples

# Colgate-Palmolive (CL)

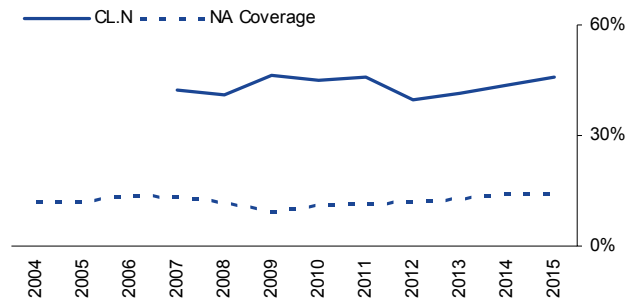
Morgan Stanley & Co. LLC **Dara Mohsenian, CFA**

**Value of Growth**




Cost of Equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Colgate-Palmolive Co vs. Peers**

*FY 2012, unless noted*

| | Colgate-Palmolive Co percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | | | 9.6% | 7.3% |
| Sales '11-'13 CAGR | | | | | 3.7% | | 3.5% |
| **Returns** | | | | | | | |
| RNOA | | | | | | 39.6% | 18.5% |
| EBIT margin | | | | | | 24.2% | 18.2% |
| **Valuation** | | | | | | | |
| P/E | | | | | 16.6x | | 16.3x |
| EV/Ebit | | | | 11.3x | | | 11.5x |
| P/FCF | | | | | | 17.4x | 15.1x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | 1.0x | | | | 1.4x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Household & Personal Care Industry View: In-Line

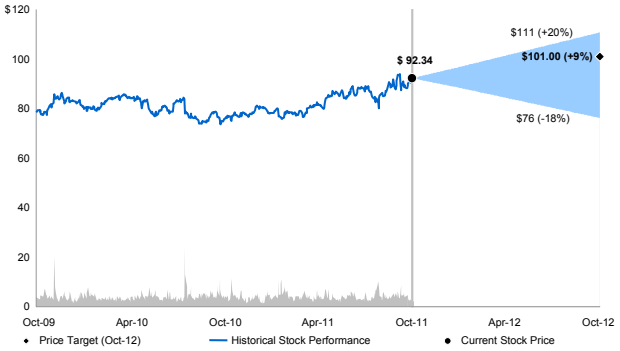
**We view Colgate as the most favorably positioned HPC company** based on (1) a superior growth profile due to its high Emerging Markets (EM) exposure, and (2) solid margin expansion potential as the price/commodity cost gap improves, particularly given Colgate's high relative pricing power. In addition, we believe CL deserves a premium valuation versus peers given its superior growth profile, EPS visibility, strategic potential, and ROIC. We project a 5-year organic sales CAGR of 4.7% and average annual operating margin expansion of ~30bps.

**Strong position in EM drives superior growth profile.** We estimate Colgate's EM exposure at 48% of revenue and 51% of operating profit versus the large-cap Staples peer averages of 24% and 20%, respectively. We believe this drives: (1) a superior volume growth profile as emerging markets continue to drive global GDP growth, and (2) higher pricing power as EM consumers are more accustomed to inflation.

**Low price elasticity and easing commodity costs should drive margin expansion.** We expect ~30 bps of average annual operating margin expansion over the next five years as Colgate's price/commodity cost gap improves with easing commodity costs and a more rational pricing environment, along with continued productivity savings. We estimate that Colgate has the best pricing power relative to its large cap HPC peers with a low pricing/volume correlation of ~31% versus a peer average of ~58%, which we believe is aided by its personal care skew.

**EM skew supports premium valuation.** We believe the market rewards EM exposure with a significantly higher multiple vs. developed markets (DM). Using key comparable HPC companies, we determine the average forward P/E and EV/EBITDA for companies with EM exposure is ~43% and ~49% higher, respectively, than those with DM exposure. Using these multiples, and based on CL's 51% EM profit exposure, we estimate that it should trade at a 16.8x weighted average P/E and 10.8x EV/EBITDA multiple, 5% and 7%, respectively, above current levels.

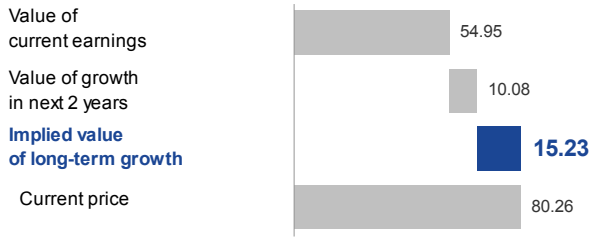
**Risk Reward on a 12-mth view (Overweight, PT $101)**



# Dollar Tree (DLTR)

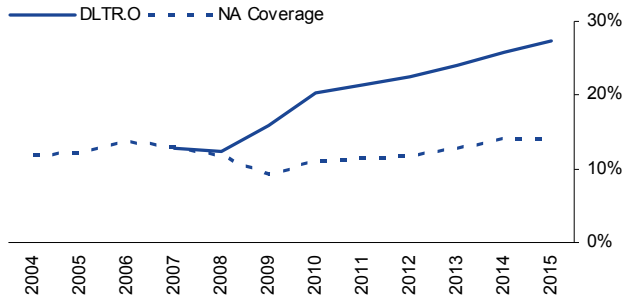
Morgan Stanley & Co. LLC **Joseph Parkhill**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Dollar Tree Inc vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Dollar Tree Inc percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| **Growth** | 0 | 20 | 40 | 60 | 80 | 100 | |
| EPS '11-'13 CAGR | | | | | | 16.6% | 15.2% |
| Sales '11-'13 CAGR | | | | 9.2% | | | 9.2% |
| **Returns** | | | | | | | |
| RNOA | | | | | | 22.5% | 16.2% |
| EBIT margin | | | | | 13.3% | | 12.7% |
| **Valuation** | | | | | | | |
| P/E | | | | | 17.1x | | 15.5x |
| EV/Ebit | | | | | 11.4x | | 10.9x |
| P/FCF | | | | | 17.7x | | 17.5x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | 1.0x | | | | 1.2x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Retail, Food & Drug Industry View: In-Line

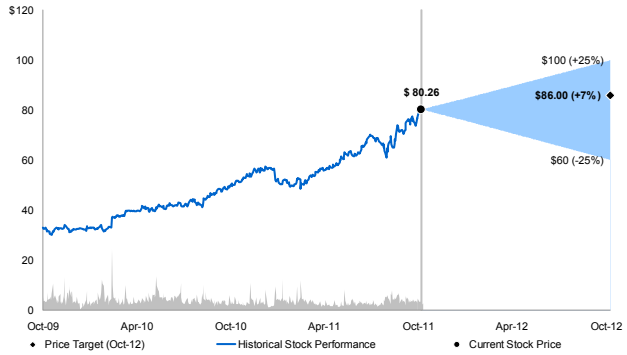
**A unique concept with visible growth.** With a clear growth trajectory driven by both 7% square footage growth and strong traffic trends, Dollar Tree has among the best earnings visibility in the Consumer sector, in our view. We maintain that Dollar Tree is a unique retailing concept, has lower competitive threats than other retailers, and can continue to grow regardless of the economic outlook.

**Large whitespace and lower competitive threats.** As a single price point operator with unique merchandise, Dollar Tree is less susceptible to competitive threats, in our view. The single price point concept is difficult to replicate and we believe it also diminishes competitive pricing threats. Dollar Tree currently operates ~4,000 stores; we believe the company has the capacity to increase its store base by at least 50%, giving it a runway for many years of high-single-digit square footage growth.

**Ability to grow in a low-growth environment.** Dollar Tree's unique value offering ($1 price point), coupled with strong in-store execution, has captured new customers throughout the downturn who keep coming back. Our annual consumer surveys show that Dollar Tree's customers' shopping intentions remain high whether the consumers' financial situation improves or deteriorates.

**Strong sales trends plus a large expansion opportunity should create operating leverage.** Strong sales should allow Dollar Tree to expand operating margins by almost 200 bps over the next three years. We believe double-digit sales growth allows the company to grow operating margins 30-50 bps annually.

**Risk Reward on a 12-mth view (Overweight, PT $86)**

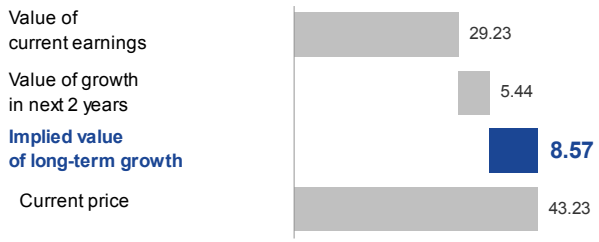


## Energy

# Enterprise Products Partners (EPD)

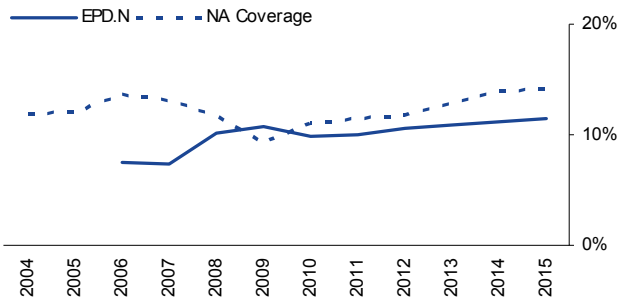
Morgan Stanley & Co. LLC Stephen J. Maresca

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Enterprise Products Partners LP vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Enterprise Products Partners LP percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | 8.5% | | | | 10.9% |
| Sales '11-'13 CAGR | | | | 7.9% | | | 8.5% |
| **Returns** | | | | | | | |
| RNOA | | | | 10.6% | | | 10.3% |
| EBIT margin | 6.2% | | | | | | 25.0% |
| **Valuation** | | | | | | | |
| P/E | | | | 18.2x | | | 18.0x |
| EV/Ebit | | | | | | 17.9x | 13.9x |
| P/FCF | | | | | 13.1x | | 10.9x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | | 4.2x | | 3.6x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Midstream Energy MLPs Industry View: In-Line

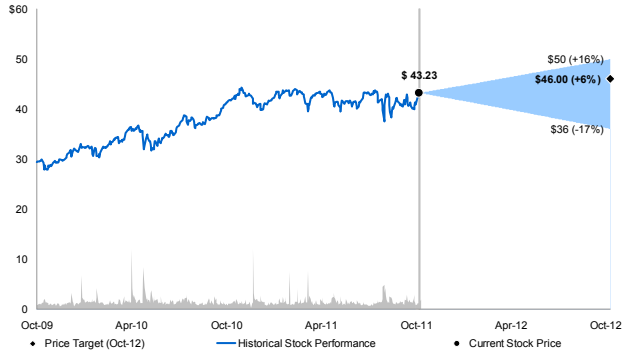
**A relative safe haven in an uncertain market.** We view EPD as a core large-cap portfolio holding that combines strong defensive characteristics (size, stability, and trading liquidity) in a volatile market with attractive long-term distribution growth. Fundamental stability is driven by a large, diversified asset base; substantial and varied liquidity sources; a prudent cash distribution policy; and a predominantly fee-based contract structure, while we believe a broad opportunity set of growth projects and selective acquisitions should support 5-6% annual distribution growth.

**Thematic exposure to natural gas/NGL midstream infrastructure build-out as a fully integrated MLP.** Strong petrochemical demand for NGLs coupled with increased producer focus on NGL-rich natural gas drilling are driving a critical need for vast midstream infrastructure build-out, a secular theme that we believe is both sustainable and investable over the next decade. We believe MLPs that have interconnected assets and a downstream NGL fractionation/storage presence at the Mont Belvieu, Texas, NGL hub — where EPD has built a leading presence — are best positioned for this build-out.

**We view EPD as the standard for vertical integration and synergistic business building.** The ability to offer a full portfolio of integrated midstream services has become increasingly important to oil and gas producer customers. EPD's growth strategy has created an expansive, connected natural gas and NGL midstream footprint that provides a large set of future high-IRR organic growth (15-25%) around existing assets.

**Sustainable cost of capital advantage underscores EPD's history of investor-friendly strategic decisions.** EPD's lack of general partner interest provides a sustainably better cost of capital (as all cash distributed stays with EPD unitholders). Compared to other large cap peers, we believe EPD has a 350 basis point equity cost advantage.

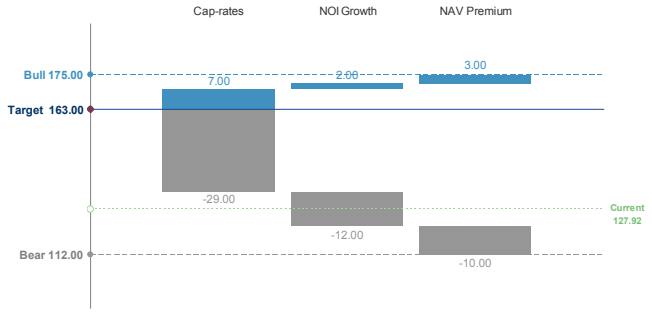
**Risk Reward on a 12-mth view (Equal-weight, PT $46)**



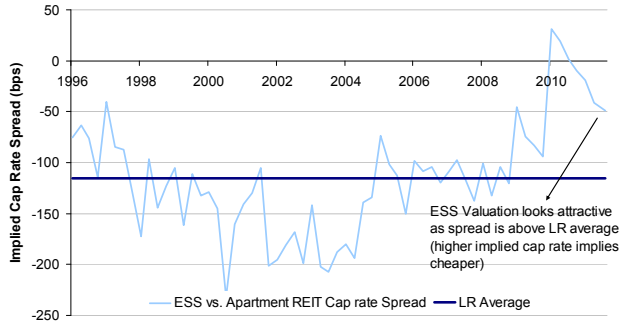
# Essex Property Trust (ESS)

Morgan Stanley & Co. LLC **Paul Morgan**

### Base-to-Bull-to-Bear Progression




### Implied Cap Rate Spread Suggests Attractive Valuation




### Peer Yardsticks

**Essex Property Trust, Inc. vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Essex Property Trust, Inc. percentile range (0 – 20 – 40 – 60 – 80 – 100) | Peer median |
|---|---|---|
| **Growth** | | |
| Sales '11-'13 CAGR | 7.8% | 3.9% |
| **Returns** | | |
| EBIT margin | 35.2% | 35.5% |
| **Valuation** | | |
| P/FFO | 19.8x | 13.6x |
| **Leverage** | | |
| Net Debt/Ebitda ('11) | 8.5x | 6.6x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

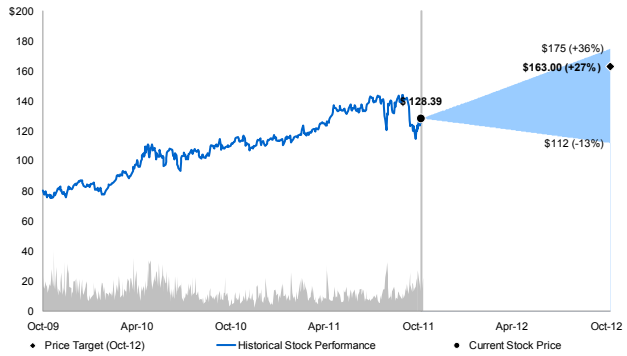
Real Estate Investment Trusts Industry View: Attractive

**Essex Property Trust – West Coast apartment REIT.** We believe Essex stands to benefit from (1) a secular decline in home-ownership — particularly among younger age cohorts — due to shifting attitudes toward the benefits of renting, as well as the impact of more stringent mortgage lending standards; and (2) more sustainable and robust growth from "knowledge economy" markets including San Francisco, Silicon Valley, Seattle, and San Diego (a combined ~56% of Essex's operating income).

**Same-store growth is just part of the story.** Essex has a strong track record of value-added investments to boost earnings and NAV growth — including debt and preferred equity investments, distressed asset acquisitions, and ground-up development. The company's development and redevelopment pipeline has grown to ~$500 million (8% of asset value), which should drive meaningful NAV growth (we model $7 of 2012 NAV from land/construction in progress). Non same-store assets materially enhance growth — in 2011, we expect same-store NOI to grow 6%, but total NOI growth should be closer to +17%.

**Essex's markets have excellent medium-term demand/supply dynamics,** in our view. West Coast metro areas have higher "beta" apartment markets due to strong barriers to supply growth and pro-cyclical industry concentrations (e.g., Internet and biotech sectors) that drive the demand side. The barriers to supply also constrain the single-family market, where land and regulatory constraints combine with high income levels to translate into housing values far above national averages. As a result, Essex stands to benefit from low levels of single-family housing affordability relative to competitors. This advantage has been increased as a result of the recent (October 1, 2011) reduction in GSE conforming loan limits for high-cost housing markets, which include all of the core portfolio markets for Essex.

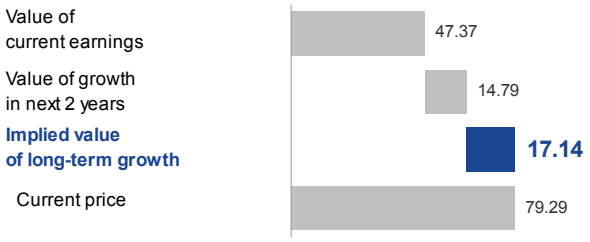
### Risk Reward on a 12-mth view (Overweight, PT $163)



# IHS Inc. (IHS)

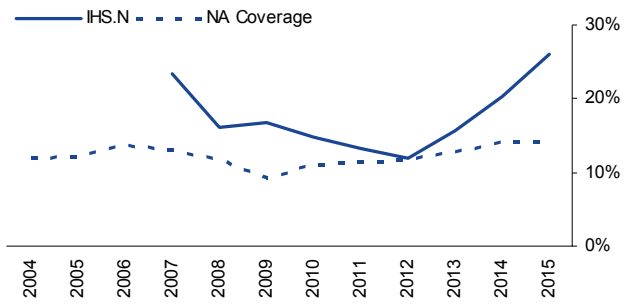
Morgan Stanley & Co. LLC **Suzanne E. Stein**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**IHS Inc. vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | IHS Inc. percentile range (0 – 100) | Peer median |
|---|---|---|
| **Growth** | | |
| EPS '11-'13 CAGR | 22.8% | 13.9% |
| Sales '11-'13 CAGR | 12.7% | 6.5% |
| **Returns** | | |
| RNOA | 12.0% | 12.0% |
| EBIT margin | 19.6% | 18.2% |
| **Valuation** | | |
| P/E | 19.0x | 12.9x |
| EV/Ebit | 17.6x | 7.5x |
| P/FCF | 15.6x | 13.9x |
| **Leverage** | | |
| Net Debt/Ebitda ('11) | 1.7x | 1.6x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

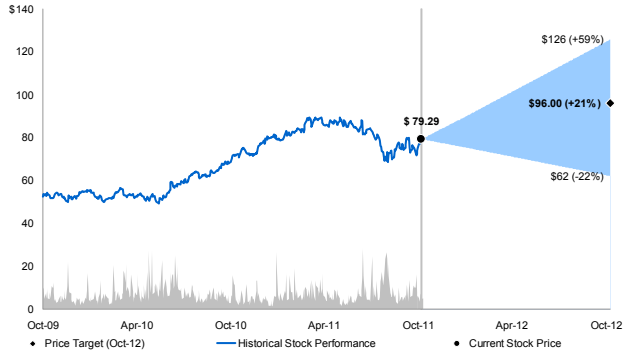
Business & Education Services Industry View: In-Line

**IHS has one of the most attractive business models in our Business Services coverage**, in our view, offering proprietary products with high customer retention, strong cash conversion rates, and predictability of results. Almost 80% of the business is subscription-based, providing high revenue visibility. Customers operate their businesses more effectively without the data and analytics that IHS supplies, and the company has vast databases that would likely be cost-prohibitive and extremely difficult for competitors to reconstruct. The company is a leading provider of data and analytics for the Energy, Product Lifecycle, Security, and Environment end-markets, and its scale, data quality, and proprietary processes result in considerable barriers to entry.

**We believe IHS has significant potential for growth and margin expansion both in the near- and long-term.** Organic top-line growth will be driven by pricing, gaining penetration, and new products and geographies, while additional growth should come from the company's acquisitions. The company is ramping up its sales force in geographies where it has potential for faster growth, such as Asia and Latin America, while new product introductions, a sales force automation tool, and a new website should facilitate cross-selling to existing customers.

**Initiatives and leveraging scale should support margin expansion.** IHS is working to build an infrastructure that supports its growth through investing in an enterprise resource planning system (its Vanguard initiative), a multi-year project to replace all of its billing systems and general ledgers, cleanse customer and product data, and put a governance structure in place to manage its business in a consistent manner globally. The initiative is being phased in and is expected to be complete in 2012. The company is also consolidating its data centers from 50 to 3, which should allow it to eliminate duplicative costs.

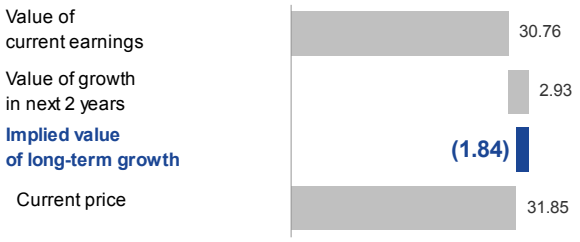
**Risk Reward on a 12-mth view (Overweight, PT $96)**



# Oracle Corp. (ORCL)

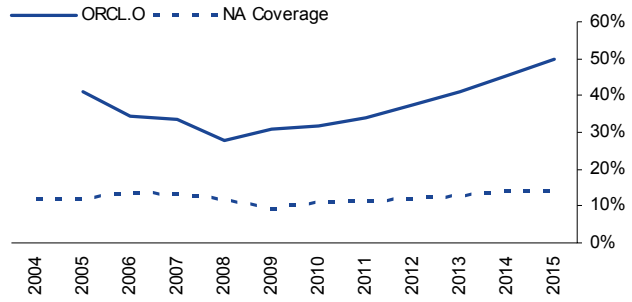
Morgan Stanley & Co. LLC **Adam Holt**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Oracle Corporation vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Oracle Corporation percentile range (0 / 20 / 40 / 60 / 80 / 100) | Peer median |
|---|---|---|
| **Growth** | | |
| EPS '11-'13 CAGR | 12.3% | 14.7% |
| Sales '11-'13 CAGR | 8.4% | 12.7% |
| **Returns** | | |
| RNOA | 37.4% | 26.7% |
| EBIT margin | 46.0% | 22.7% |
| **Valuation** | | |
| P/E | 11.6x | 26.5x |
| EV/Ebit | 6.5x | 22.1x |
| P/FCF | 11.6x | 23.9x |
| **Leverage** | | |
| Net Debt/Ebitda ('11) | | 0.2x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

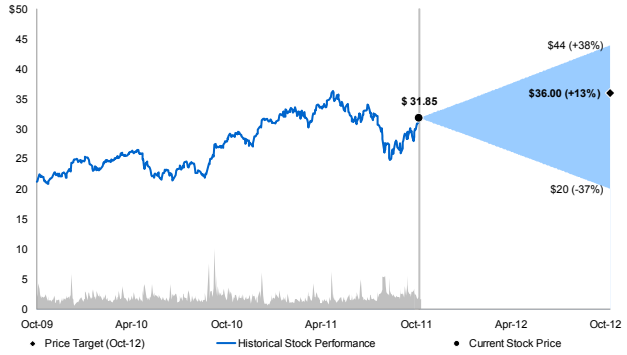
For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Software Industry View: In-Line

**Comprehensive product portfolio creates sustainable growth opportunities.** Through acquisition and organic development, Oracle created what we regard as the most comprehensive portfolio of enterprise software assets in the industry. This portfolio should drive strategic advantage and growth opportunities on several fronts, including: (1) upselling of additional products into their installed base of over 380,000 customers, (2) bringing to market complete and integrated IT solutions, and (3) achieving high levels of price/performance by optimizing software to run on purpose-built hardware platforms. With over $4 billion a year in annual R&D spend, Oracle is able to quickly incorporate new technologies into their products and benefit from secular drivers like "Big Data". With some of the best execution in the tech industry and a $15 billion base of recurring support revenues garnering over 80% contribution margins, we expect margins to continue moving upwards and help sustain 15%-plus EPS growth at Oracle for the next several years.

**Oracle's complete software stack targets over $200 billion in market opportunity**. Oracle's product portfolio now extends from applications that automate business processes, analytical tools for optimizing those business processes, down through the middleware and database layers, which represents the plumbing and underlying engines that drive those applications, and now the hardware assets upon which all this software runs — a complete application-to-disk technology stack. Oracle will soon start bringing this portfolio to a public cloud-based delivery model. We estimate the addressable market for Oracle's software portfolio alone at over $200 billion. Oracle can sell customers complete integrated solutions, greatly reducing the integration costs that represent a large portion of implementing new IT solutions, or sell incremental functionality around existing implementations of Oracle technology. The penetration of Oracle technologies into this customer base is still low — with over 9,000 products in Oracle's portfolio, 90% of its customers have less than 5.

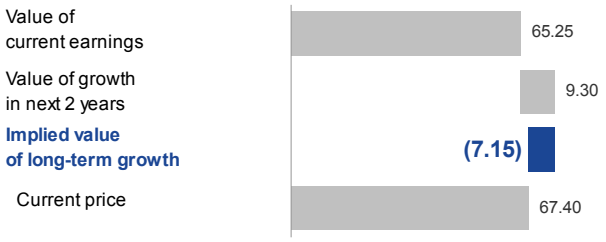
**Risk Reward on a 12-mth view (Overweight, PT $36)**



# Philip Morris International (PM)

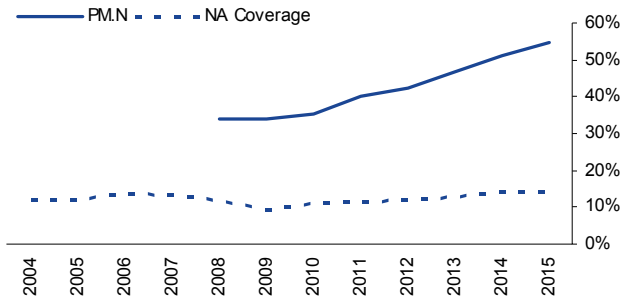
Morgan Stanley & Co. LLC David J. Adelman

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Philip Morris International Inc vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Philip Morris International Inc percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | | 9.6% | | 7.5% |
| Sales '11-'13 CAGR | | | | | 3.5% | | 2.1% |
| **Returns** | | | | | | | |
| RNOA | | | | | 42.3% | | 22.3% |
| EBIT margin | | | | | | 44.1% | 41.6% |
| **Valuation** | | | | | | | |
| P/E | | | | 13.2x | | | 13.2x |
| EV/Ebit | | | | 9.5x | | | 9.5x |
| P/FCF | 12.4x | | | | | | 13.2x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | 1.2x | | | 1.2x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

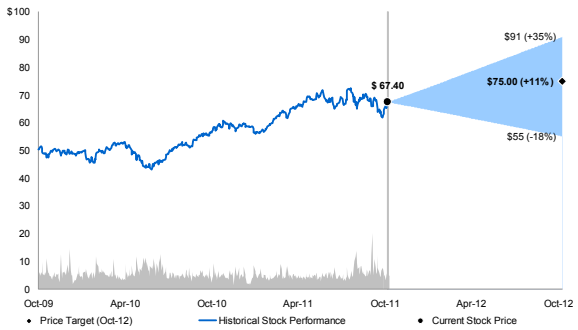
Tobacco Industry View: In-Line

**Philip Morris International (PM) possesses a number of sustainable structural competitive advantages** relative to both its global Tobacco and Consumer Staples peers, in our view, including: (1) Significant geographic diversification, including roughly 50% of total sales in Emerging Markets; (2) An outstanding brand portfolio with attractive demographics and market leadership in many countries; (3) Robust pricing power, enhanced by the industry's oligopolistic structure; (4) Limited commodity input exposure; (5) Substantial free cash flow generation; (6) Relative leverage over the retail trade; (7) A relatively underleveraged balance sheet; (8) Scope for further cost savings; and (9) A recession-resilient business model.

**PM has demonstrated a consistent focus on generating best-in-class shareholder returns within Consumer Staples**, in our view, as evidenced by: (1) Annual dividend increases (the company has now cumulatively increased its dividend by 67% since mid-2008) and 60-65% target dividend payout ratio; and (2) a robust share repurchase program (PM has repurchased $18.9 billion in common stock, or 16% of shares outstanding, since its spin-off in March 2008).

**We believe PM has achieved a clear acceleration in underlying profit growth since its 2008 separation** from Altria, and we expect the company to continue to achieve its long-term target of 6-8% underlying operating profit growth, driven by: (1) A broad-based improvement in industry net pricing trends, including more limited competitive skirmishes; (2) A lower incidence of destabilizing excise tax increases, and a shift toward more constructive tax structures; (3) PM's ongoing geographic mix shift toward faster-growth Emerging Markets; (4) Improved innovation around Marlboro; and (5) The potential retention of temporary share gains in the highly-profitable Japan market following earthquake-related competitive supply disruptions.

**Risk Reward on a 12-month view (Overweight, PT $75)**

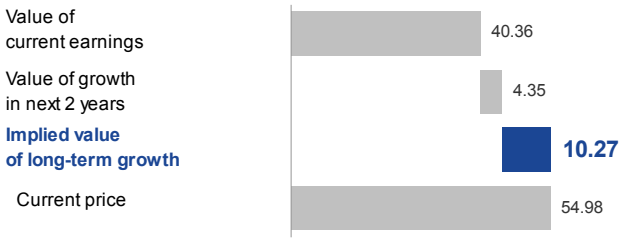


## Technology

# Qualcomm (QCOM)

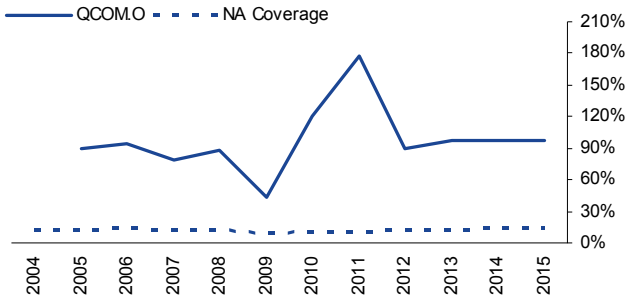
Morgan Stanley & Co. LLC **Ehud Gelblum**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Qualcomm Inc. vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Qualcomm Inc. percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| **Growth** | 0 | 20 | 40 | 60 | 80 | 100 | |
| EPS '11-'13 CAGR | | | | | 13.0% | | 11.0% |
| Sales '11-'13 CAGR | | | | | | 15.9% | 10.4% |
| **Returns** | | | | | | | |
| RNOA | | | | | | 90.3% | 12.3% |
| EBIT margin | | | | | | 38.8% | 7.3% |
| **Valuation** | | | | | | | |
| P/E | | | | 15.5x | | | 15.8x |
| EV/Ebit | | | | 10.4x | | | 9.4x |
| P/FCF | | | | 18.1x | | | 22.0x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | | | | 22.5x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Commun. Equip. & Data Networking Industry View: In-Line

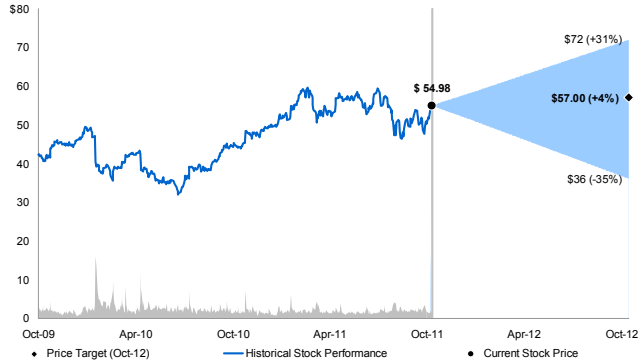
**We believe QCOM is a play on smartphone growth and 3G adoption,** for the most part free of the intensifying competition in the OEM market from handset styles and competing operating systems. We expect Qualcomm to continue to benefit from the strong growth in smart devices driving adoption of its high-end, higher-margin Snapdragon integrated chipsets.

Powering roughly 60% of Android devices, which we expect grow 132% in C2011 to 156 million units shipped, we believe Qualcomm continues to gain integrated apps processor share lifting Qualcomm CDMA Technologies (QCT) operating margins back to the mid 20s over time. We also expect the iPhone 4S and new iPad to drive another 90 million-plus chips through the model per year, contributing $0.25-0.30 to EPS, while RIM's late-stage switchover to Qualcomm's Snapdragon chips to power nearly all of its new BB7 lineup could at first add 4 million high-margin Snapdragon chips per quarter, ramping quickly to as many as 8-10 million/quarter by mid 2012. Longer term, we believe Qualcomm is best positioned to benefit from Nokia's partnership with Microsoft/Windows as it is currently the only qualified chip provider into Microsoft Windows Phone 7 and windows Mango, potentially adding 70 million-plus units and $0.60-0.70 to EPS from Nokia annually by 2014/15.

Qualcomm is also investing in mobile computing, with form factors (e.g., super-light, super-thin) coming out on the ARM-based Windows 8 platform being far superior to the form factors of PCs using the Wintel architecture (requiring, for example, larger batteries). We expect growing support from PC OEMs for Windows 8 on ARM to benefit Qualcomm.

Ultimately, we believe the increasing complexity and adoption of multi-mode and next gen technology by carriers widens the technology gap between Qualcomm and competitors, driving a favorable pricing environment and higher operating leverage.

**Risk Reward on a 12-mth view (Overweight, PT $57)**



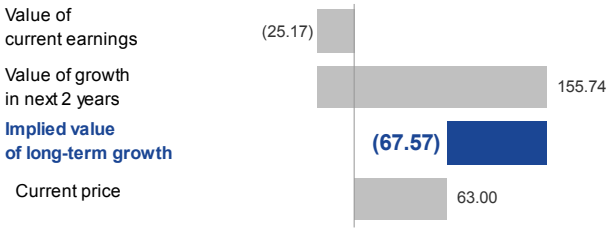
## Financials

MORGAN STANLEY
BEST IDEA

# RenaissanceRe (RNR)

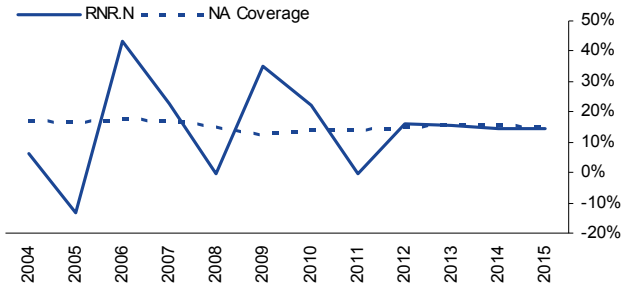
Morgan Stanley & Co. LLC **Gregory W. Locraft**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Equity (ROE)**




**Peer Yardsticks**
**RenaissanceRe Holdings Ltd. vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | RenaissanceRe Holdings Ltd. percentile range (0 / 20 / 40 / 60 / 80 / 100) | Peer median |
|---|---|---|
| **Growth** | | |
| NWP '11-'13 CAGR | 11.5% | 4.0% |
| BVPS '11-'13 CAGR | 14.1% | 8.3% |
| **Returns** | | |
| Operating ROE | 15.6% | 9.2% |
| **Valuation** | | |
| P/E | 6.2x | 8.3x |
| P/B | 0.9x | 0.7x |
| **Leverage** | | |
| Total Debt / Capital ('11) | 23% | 21% |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Property & Casualty Insurance Industry View: In-Line

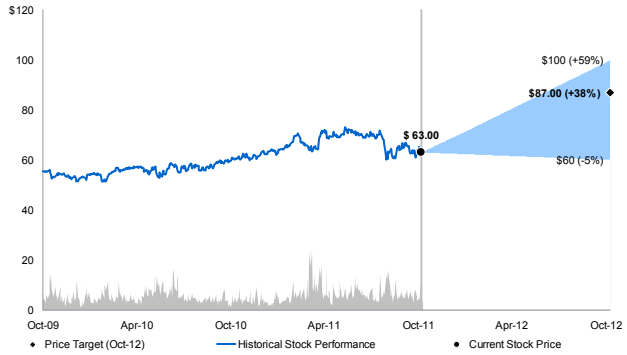
**RNR is a pure play investment in property reinsurance, the fastest growth segment in P&C.** RenRe possesses the highest ratings in reinsurance and we estimate $600 million in excess capital (20% of equity) should allow RNR to take full advantage of changes in the supply/demand dynamic in property reinsurance.

**We expect rising property reinsurance pricing power and demand through 2012 and a broadening P&C cycle turn into 2013.** Every 500bps of pricing leads to 15% EPS growth for RenRe, driving our 2012-13e EPS ~25% higher than consensus. We estimate the company has $600 million of excess capital to help accelerate organic growth in an improving marketplace.

**Valuation seemingly ignores RenRe's track record of superior long-term returns.** RenRe boasts an impressive 18-year track record of double-digit growth with an average ROE of 20%-plus, putting it well ahead of peers. Since inception in 1993, RenRe has generated compounded BVPS growth of 21% per year. Morgan Stanley's "What's in the Price" valuation tool shows RNR shares embed only a 6% ROE in perpetuity vs its 24% average since inception and our ~15% estimates for 2012-13. Yet RNR's valuation is currently near all time lows of 1.1x book vs the 1.6x cross-cycle average in spite of the improving outlook.

RenRe is concentrated in short-tail property underwriting which has proven to be a faster growth, higher return segment over the long term. The long-term CAGR of losses in this marketplace is 6%, meaning insured risks grow across the cycle given weather patterns, population, wealth density near the coasts, etc. RenRe's low-frequency, high-severity underwriting model drives a 'binary' return profile in earnings results. Since inception, RenRe has seen only 3 years when operating ROE dropped below 10%. The rest of the time RenRe's results were above 15% (average 28%). RenRe never produced "average" returns of 10–15%, so for 2 decades RenRe investors could enter each underwriting year presuming an 80%-plus probability of a 15%-plus ROE.

**Risk Reward on a 12-mth view (Overweight, PT $87)**



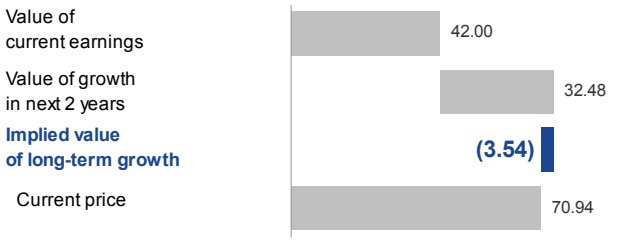
Energy

MORGAN STANLEY
BEST IDEA

# Schlumberger (SLB)

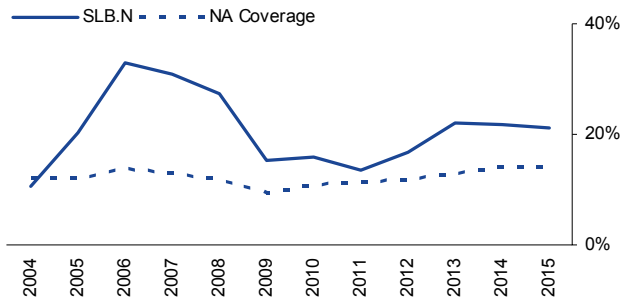
Morgan Stanley & Co. LLC **Ole Slorer**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Schlumberger vs. oil services companies under our coverage**

*FY 2012, unless noted*

| | Schlumberger percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | | | 43.0% | 31.3% |
| Sales '11-'13 CAGR | | | | | | 23.7% | 18.0% |
| **Returns** | | | | | | | |
| RNOA | | | | | 16.8% | | 14.2% |
| EBIT margin | | | | 20.6% | | | 20.6% |
| **Valuation** | | | | | | | |
| P/E | | | | | 13.5x | | 9.9x |
| EV/Ebit | | | | | 10.5x | | 7.9x |
| P/FCF | | | | 24.3x | | | 20.9x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | 0.6x | | | | 1.2x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

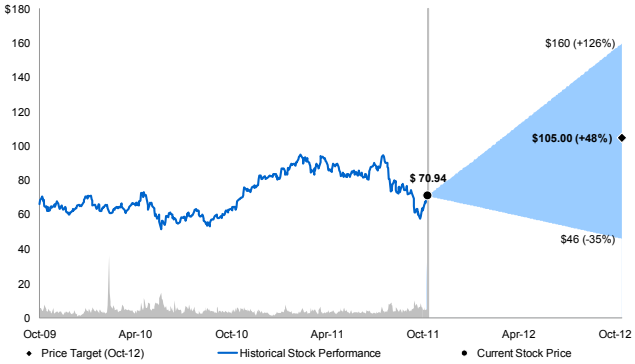
Oil Services, Drilling & Equipment Industry View: Attractive

**Schlumberger is increasingly becoming a unique investment opportunity,** in our opinion. Thanks to an estimated $1 billion investment per year in R&D, Schlumberger has what we consider the most advanced technology portfolio in the industry. Its fundamentals are impressive, with what we think are some of the best field personnel, a pristine service and performance reputation, and leading market share in most of its product lines.

Schlumberger had quite a run since 2000, quadrupling in size, shifting its geographic mix toward the Eastern Hemisphere, and expanding its dominance with national oil companies. The industry has come off a five-year upcycle in E&P investment characterized by a North American natural gas drilling ramp (in 2004-06) and an increase in Eastern Hemisphere development activity (2006 through mid-2008, with substantial expenditures in Saudi Arabia and, most notably, Mexico and Russia). However, sharply increased spending has not led to a significant supply response due to an aging production base and high depletion rates, as well as the time needed for exploration to translate to new production.

We expect the next decade to be characterized by an increased offshore fleet and the start of a new wave of exploration while trying to stem decline in the existing production base. Schlumberger looks uniquely positioned throughout the oilfield service value chain, thanks to its ability to seamlessly integrate seismic, drilling, measurement, and completion technologies, and package them into integrated projects. We see Schlumberger's high-barrier-to-entry technologies as a perfect match to the future challenges of the oil and gas industry. We believe those technologies, coupled with unmatched service quality, should command a premium and allow Schlumberger to gain market share in the next upcycle.

**Risk Reward on a 12-mth view (Overweight, PT $105)**



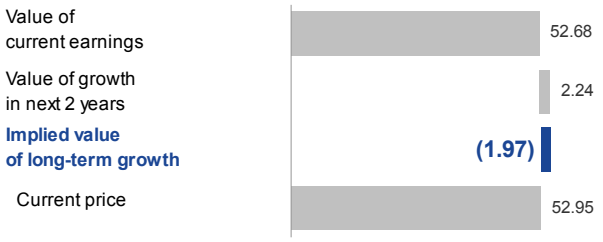
## Consumer Staples

MORGAN STANLEY
BEST IDEA

# Target (TGT)

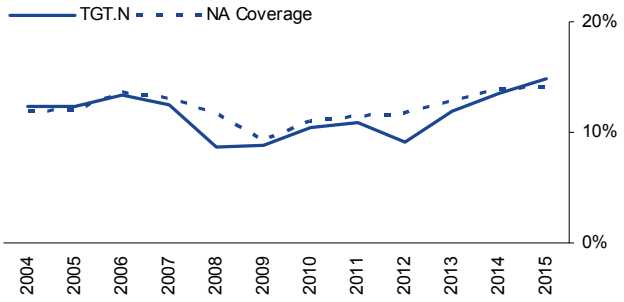
Morgan Stanley & Co. LLC **Mark Wiltamuth**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**Target Corp. vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | Target Corp. percentile range (0 – 20 – 40 – 60 – 80 – 100) | Peer median |
|---|---|---|
| **Growth** | | |
| EPS '11-'13 CAGR | 7.8% | 8.3% |
| Sales '11-'13 CAGR | 4.7% | 5.1% |
| **Returns** | | |
| RNOA | 9.1% | 8.5% |
| EBIT margin | 7.3% | 6.2% |
| **Valuation** | | |
| P/E | 12.6x | 12.6x |
| EV/Ebit | 9.7x | 10.5x |
| P/FCF | 14.2x | 11.1x |
| **Leverage** | | |
| Net Debt/Ebitda ('11) | 2.6x | 2.6x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Retail, Retail, Food and Drug Industry View: In-Line

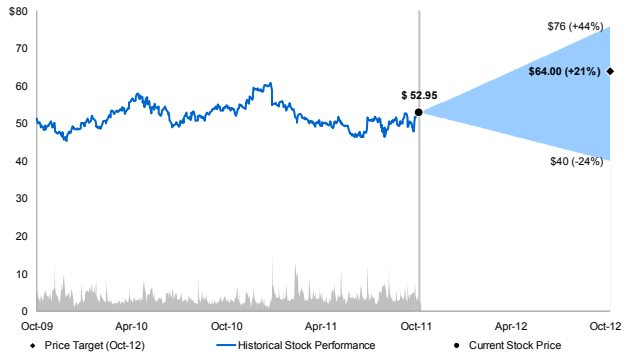
**Looking through near-term Canadian start-up costs, we see a compelling longer-term value buy.** We see a significant middle market opportunity in Target's entry into Canada and a retailer that can drive stable growth in the US. With TGT's valuation near a 15-year low, we see valuation recovery once investors look forward to the 16-20% EPS growth and rising free cash flow in 2013 and beyond.

We believe investors are applying both a P/E discount and an earnings hit for Target's startup costs in Canada. As our analysis indicates Canada should be a positive NPV project, we believe investors should look through near-term dilution and focus on the $0.80/share earnings potential we see by 2017.

Execution on Canadian plans is important, but we expect investors to focus to the core US business, which is all of the company's earnings today and should still be 90% of estimated earnings in 2017. Over the past two-years, Target has introduced two sales-driving programs (RedCard and PFresh) that aim to increase customer loyalty, make the Target trip more relevant for everyday needs, and improve price positioning in the eyes of its most valued customers. We believe that these programs will produce sticky sales, driving ~3% comps in the US over the long-term. Combined with 2% unit growth, we estimate that Target can produce US sales growth approaching 5% annually.

**We see an accelerating EPS and free cash flow story, with a sharp positive inflection coming in 2013.** After anemic growth in the Canada startup cost years of 2011/2012, we see 16-20% EPS growth in 2013and beyond, free cash flow nearly doubling to a 13% FCF yield by 2014, and returns climbing upward. Stock buybacks could contribute 4-5% to EPS growth in 2014 and thereafter.

**Risk Reward on a 12-mth view (Overweight, PT $64)**



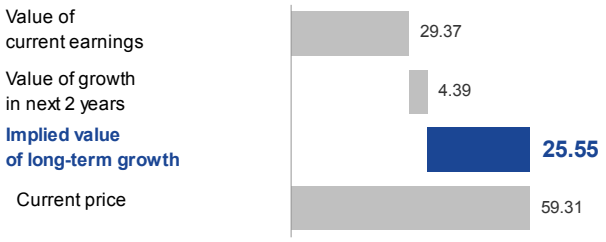
## Technology

MORGAN STANLEY
BEST IDEA

# Teradata (TDC)

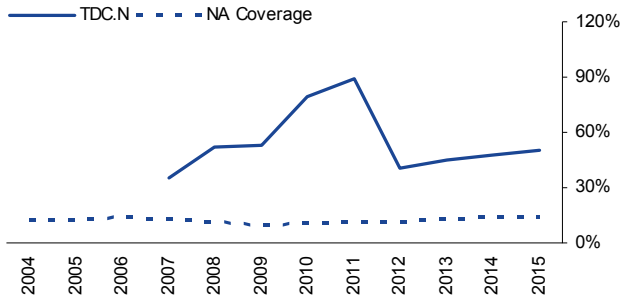
Morgan Stanley & Co. LLC **Katy L. Huberty, CFA**

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**
**Teradata vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | Teradata percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | | 15.5% | | 7.7% |
| Sales '11-'13 CAGR | | | | | 12.2% | | 4.0% |
| **Returns** | | | | | | | |
| RNOA | | | | | | 40.8% | 26.3% |
| EBIT margin | | | | | | 22.6% | 11.8% |
| **Valuation** | | | | | | | |
| P/E | | | | | | 23.3x | 9.5x |
| EV/Ebit | | | | | | 15.5x | 6.6x |
| P/FCF | | | | | | 27.6x | 10.9x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | | | | 0.7x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Systems and PC Hardware Industry View: In-Line

**We believe Teradata's revenue growth is accelerating despite economic uncertainty**, driven by:

**(1) Significant increases in sales people and consultants.** Since it was spun out of NCR in late 2007, Teradata increased its sales teams by 40% and consultants by 60%. Teradata is just now hitting the sweet spot of growth from these investments.

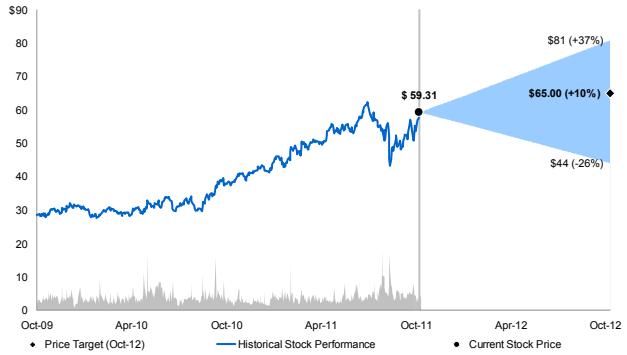
**(2) Recent acquisitions extending Teradata's customer base and software offerings,** specifically Aprimo (helps companies improve marketing and demand generation programs) and Aster Data (allows analysis of new data types generated by social networks, digital marketing, and fraud detection programs). This higher software mix should put upward pressure on gross margins.

**(3) Strong market growth in spending on data analytics,** as companies seek out new tools to better optimize their business and ultimately maximize revenue and profits. For example, retailers use data analytics to improve marketing to their target customers and banks use it to improve visibility and timeliness of risk metrics.

**While Teradata's sweet spot is selling to Global 3,000 companies, where it has over one-third of the market, we see a longer-term opportunity for Teradata to expand into the mid-market** given high demand for more affordable analytics appliances. The mid-market more than doubles Teradata's addressable market, in our view.

**Teradata believes its competitive positioning is as strong as it has ever been, and expects sustainable, long-term revenue growth above 10%** vs. 7-9% previously. We model 15% revenue CAGR from C2010-13 driven by accelerated sales force expansion, top-line synergies from Aprimo and Aster Data, consulting services build-out, and potential mid-market partnerships.

**Risk Reward on a 12-mth view (Overweight, PT $65)**



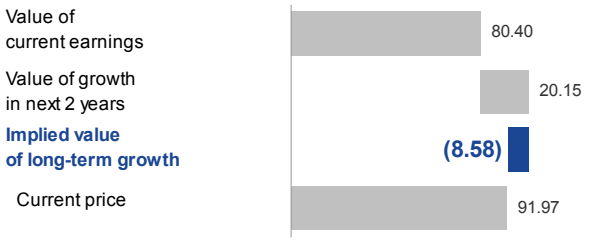
## Industrials

MORGAN STANLEY
BEST IDEA

# Union Pacific (UNP)

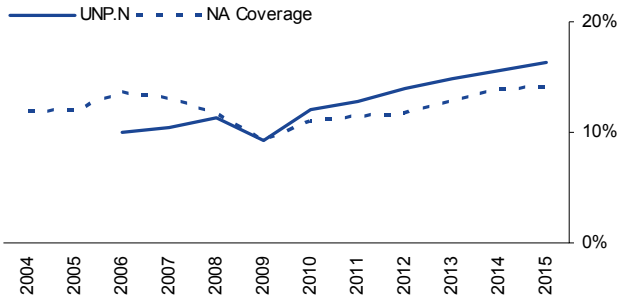
Morgan Stanley & Co. LLC William J. Greene, CFA

**Value of Growth**




Cost of equity uses 5-yr beta, Rf of 4% and MRP of 4%

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**
**Union Pacific Corp. vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | Union Pacific Corp. percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | 18.2% | | | 19.1% |
| Sales '11-'13 CAGR | | | | | 7.3% | | 6.1% |
| **Returns** | | | | | | | |
| RNOA | | | | | 14.0% | | 12.1% |
| EBIT margin | | | | | | 33.2% | 11.4% |
| **Valuation** | | | | | | | |
| P/E | | | 11.8x | | | | 12.2x |
| EV/Ebit | | | | 7.9x | | | 8.5x |
| P/FCF | | | 17.5x | | | | 18.2x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | 1.5x | | | | 1.9x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

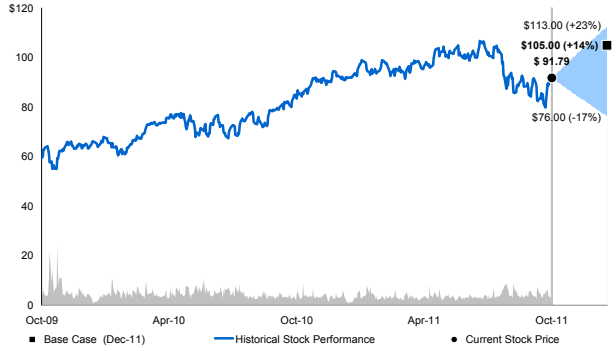
For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Freight Transportation Industry View: In-Line

**We recommend Union Pacific, a Morgan Stanley Best Idea, as one of the most compelling stocks in Freight Transportation.** We are bullish on the rail industry's advantage over its truck competitors including lower unit costs for high tonnage freight and greater customer captivity. Given UNP's particularly favorable exposure to the key themes underpinning our rail thesis, we believe UNP will see secular EPS growth for the following reasons:

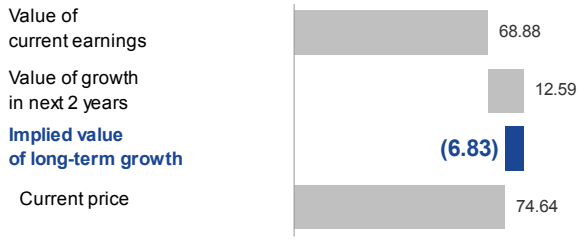
- *Latent pricing power.* We believe rails will broadly benefit from ongoing price growth because of favorable industry structure and improving competitive position vis-à-vis trucking. However, beyond this, UNP will be repricing ~$1.05 billion of legacy contracts starting in 4Q11 through 1Q12. We estimate repricing could drive legacy contract rates ~23% higher, a significant jump from the "Inflation Plus" pricing to which other rails are guiding.
- *Operating leverage to long-term volume growth.* Historically, rail volumes have moved in line with real GDP. However, western rails should benefit from growth in US grain exports, US containerized imports from Asia, and favorable western US population demographics. Though the risk of lower trend GDP growth could weigh on volume growth, our 2% volume CAGR assumption in 2012–15 is likely to be amplified by operating leverage.
- *Long-term productivity improvement:* UNP recently announced a target of reaching a 65-67% operating ratio by 2015 — conservative guidance, in our opinion. We suspect that productivity improvements are sustainable as volumes recover and predict that incremental margins will exceed 40% through 2015.
- *Valuation should re-rate over coming years:* UNP's forward P/E is about 2 points below recent historical averages of ~14x and our own regression work which suggests a re-rating to ~15x is likely in the 2012-15 timeframe.

**Risk Reward View (Overweight, Price Target $105)**



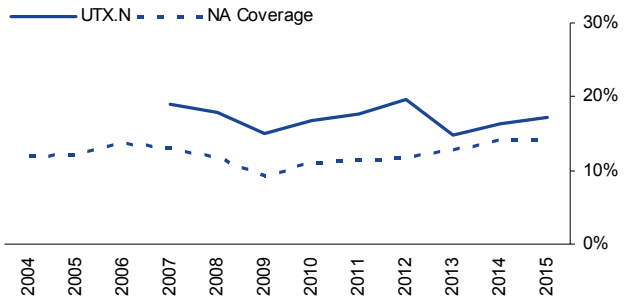
# United Technologies (UTX.N)

**Value of Growth**




Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**

**United Technologies vs. Analyst Coverage Universe**

*FY 2012, unless noted*

| | United Technologies percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | 14.2% | | | 13.3% |
| Sales '11-'13 CAGR | | | | | 12.7% | | 8.4% |
| **Returns** | | | | | | | |
| RNOA | | | | | 19.6% | | 16.1% |
| EBIT margin | | | | | 14.4% | | 11.5% |
| **Valuation** | | | | | | | |
| P/E | | | | | 12.4x | | 9.6x |
| EV/Ebit | | | | | 9.8x | | 8.7x |
| P/FCF | | | | 10.5x | | | 11.0x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | 0.9x | | | | | | 1.6x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Aerospace & Defense Industry View: Attractive

Morgan Stanley & Co. LLC **Heidi Wood**

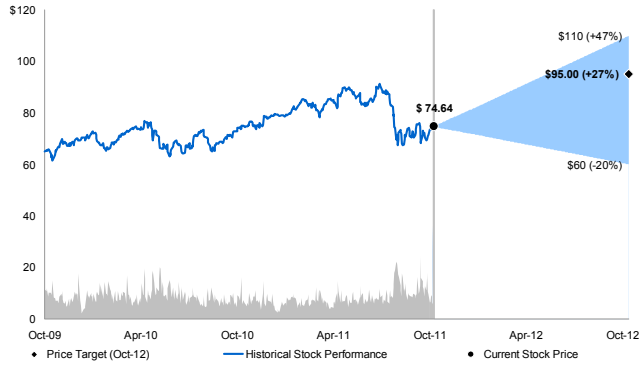
**United Technologies, with the pending addition of Goodrich, is best positioned for the wave of aerospace aftermarket that we see ahead.** We strongly prefer aerospace suppliers in lieu of manufacturers as the preferred way to play the aero delivery up-cycle, with the high margin aero aftermarket yet ahead. With the acquisition of Goodrich (anticipated 1H12 close), United Technologies would surpass Honeywell as the #1 aerospace systems supplier, adding to the company's #1 position in helicopters and #3 in engines.

**Multi-year aero aftermarket ahead.** United Technologies generates ~65% of operating income from the less cyclically sensitive aftermarket, which should cushion profits in economic down-cycles, but afford it the full effects of upturns. We anticipate United Technologies' well positioned aerospace businesses will continue to drive near-term results with the true power of the franchise kicking in with an improved macro. We think a 2012–15 EPS CAGR of 13% looks credible and achievable.

**Revenue diversification and margin expansion via market-leading international businesses.** United Technologies maintains a diversified revenue base (50% aerospace/50% industrial) via six business lines and generates ~60% of revenue internationally with a strong presence in key developing markets. Management has delivered material margin improvement across all the company's businesses and we believe opportunities exist for further margin expansion.

**Strong balance sheet and free cash flow generation.** Not only is United Technologies' execution best in class, in our view, with a debt/cap ratio of 21% and a free cash flow conversion ratio of 115%, solid execution is supported by a strong financial position.

**Risk Reward on a 12-mth view (Overweight, PT $95)**

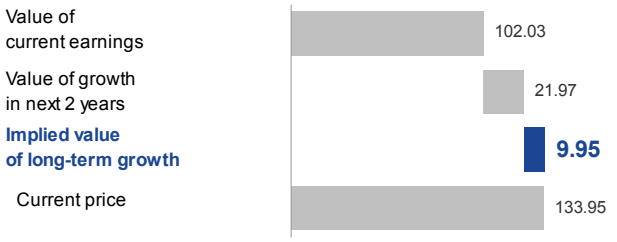


## Consumer Discretionary

# VF Corp (VFC)

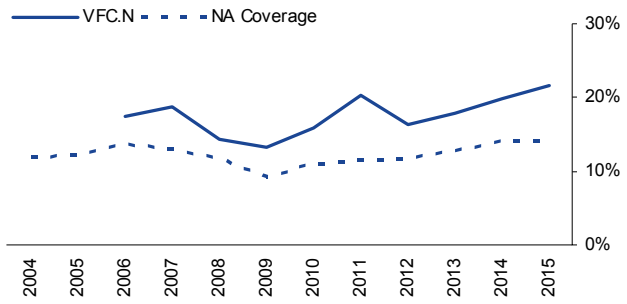
Morgan Stanley & Co. LLC **Joseph Parkhill**

**Value of Growth**




Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**
**VF Corp vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | VF Corp percentile range | | | | | | Peer median |
|---|---|---|---|---|---|---|---|
| | 0 | 20 | 40 | 60 | 80 | 100 | |
| **Growth** | | | | | | | |
| EPS '11-'13 CAGR | | | | 16.4% | | | 16.4% |
| Sales '11-'13 CAGR | | | | | 14.2% | | 10.6% |
| **Returns** | | | | | | | |
| RNOA | | | | 16.2% | | | 16.2% |
| EBIT margin | | | | | | 13.8% | 12.7% |
| **Valuation** | | | | | | | |
| P/E | | | 14.6x | | | | 15.5x |
| EV/Ebit | | | | 10.9x | | | 10.9x |
| P/FCF | | | | 17.4x | | | 21.6x |
| **Leverage** | | | | | | | |
| Net Debt/Ebitda ('11) | | | | | 1.5x | | 1.2x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Retail, Branded Apparel Industry View: In-Line

**Changing portfolio to drive faster growth.** VF's changing portfolio mix toward Outdoor and Action Sports should allow it to grow faster, producing mid-teens EPS growth annually. We are bullish on the Timberland acquisition and believe it will be a meaningful contributor to the top and bottom lines. Over time, we believe Timberland's operating margins can improve 500 bps.

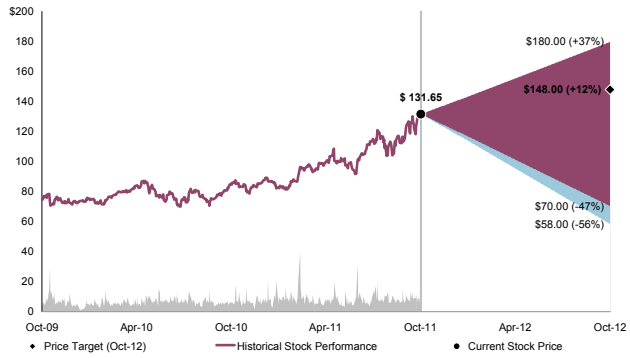
**Large global growth opportunity.** Our global market share analysis finds that VF should be able to capture an incremental $2.6 billion in global sales over the next several years. If VF were able to duplicate its 3.1% market share abroad, the company could grow revenues 190%.

**Brands appear well positioned in China.** Our July AlphaWise China Consumer survey found that both Lee Jeans and The North Face are viewed positively. Lee Jeans is one of the most well-known brands and is the fifth-most desired brand out of the 40 international brands surveyed. The North Face is also a highly desired brand and we believe it had the most differentiated positioning.

**Direct-to-consumer initiatives should add to growth.** VF intends to double its store base by 2015. We estimate new store growth should add ~4% annually to revenue growth. We believe the changing portfolio towards outdoor and action sports, global growth opportunity, coupled with retail build-out should keep revenue in the low double digits/high single digits over the next several years.

**Consistent executor and high returns.** Our analysis shows that VF has been the most consistent executor in branded apparel (lowest volatility in sales and margins). The company produces RNOA in the mid to high teens, should generate ~$1 billion in free cash flow annually, (~7% FCF yield) and has a 2% dividend yield.

**Risk Reward on a 12-mth view (Overweight, PT $148)**

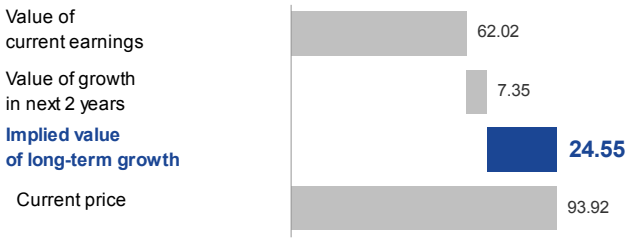


## Technology

# Visa (V)

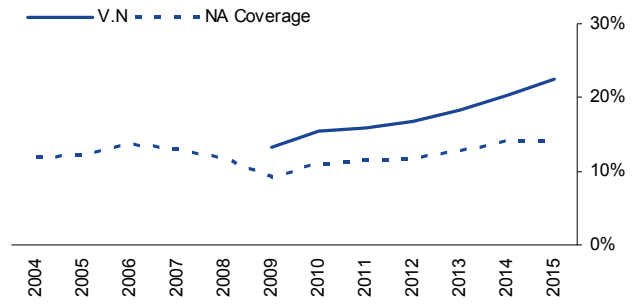
Morgan Stanley & Co. LLC **Glenn Fodor**

**Value of Growth**




Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

**Return on Net operating assets (RNOA)**




**Peer Yardsticks**
**Visa Inc. vs. Analyst Coverage Universe**
*FY 2012, unless noted*

| | Visa Inc. percentile range (0 – 100) | Peer median |
|---|---|---|
| **Growth** | | |
| EPS '11-'13 CAGR | 12.8% | 11.7% |
| Sales '11-'13 CAGR | 9.9% | 8.7% |
| **Returns** | | |
| RNOA | 16.7% | 19.6% |
| EBIT margin | 60.3% | 26.1% |
| **Valuation** | | |
| P/E | 16.9x | 15.3x |
| EV/Ebit | 8.1x | 9.5x |
| P/FCF | 17.1x | 13.7x |
| **Leverage** | | |
| Net Debt/Ebitda ('11) | | 0.3x |

Source: FactSet (historical share price data), Company data, Morgan Stanley Research estimates
Companies with fiscal years ending 1/1-5/31 have been fiscally aligned with the prior year.

For valuation methodology and risks associated with price targets mentioned, please see the appendix beginning on page 25.

Computer Services & IT Consulting Industry View: In-Line

**A key beneficiary of the global shift to electronic-based payments from cash and checks.** Visa owns the world's largest credit/debit card network. Global penetration of electronic payments remains low with 85% of the world's transactions still cash-based, leaving ample runway to support healthy growth prospects through (at least) 2015.

**Visa is well positioned in attractive segments:**

***International:*** Currently, ~43% of Visa's revenue is generated from outside the US and we expect International to remain an important growth engine as secular trends are orders of magnitude stronger than those in the US. Management is targeting 50% of revenue to come from outside the US by 2015.

***Emerging technologies:*** Visa is focused on growth opportunities from emerging technologies such as prepaid, eCommerce, mobile payments, and electronic remittances, which are in varying stages of development. Visa's incumbent position as the largest facilitator of connections between million of endpoints positions it to benefit as adoption of these e-channels accelerates.

***Debit:*** ~40% of dollar volume over Visa's network comes from debit cards, which are aligned with non-discretionary spending and hence a more defensive (and often faster-growing) form of payment than credit. While the Durbin legislation in the US could present a headwind to growth in the near-term, we believe the overall financial impact to Visa will be relatively benign.

**Highly scalable business model and secular growth should drive above-industry earnings growth.** For F2011–15, we project 10% organic revenue growth, with low 60s operating margins. Given the strong secular trends and scalable business model, cost growth does not have to move in lock-step with revenue, allowing for meaningful operating leverage. While pricing is not a key tenet to our growth thesis, we believe the model allows for modest benefit here (e.g. 100-200 bps annually).

**Risk Reward on a 12-mth view (Overweight, PT $105)**

| Stock | Valuation Methodology | Risks |
|---|---|---|
| **Amazon.com** | Our price target of $275 is derived via a DCF analysis (assuming an 11.5% hurdle rate and 5.75% perpetual growth post-2013. | (1) Amazon.com faces competitive threats from Apple/others as Media sales (37% of total revenue in CQ2) transition to digital distribution. (2) Investors capitalize working capital free cash at the same rate as operating free cash; if growth slows, this could have a meaningful impact on the stock. (3) Sales tax collection laws could be challenged as eCommerce grows. (4) Investment spending needs could be greater than expected. |
| **BorgWarner** | Our $88 price target has been derived using a DCF valuation. We use a risk free rate of 4%, market risk premium of 5.5% and a beta of 1.2 to derive cost of equity of 10%. Using after-tax cost of debt of 6% yields a WACC of 10.3%. We use a terminal growth rate of 1.5% on forecast cash flows through 2020. | (1) New technology could drive up warranty costs; (2) Europe macro risk (50% of revenues); (3) Execution issues in Europe could persist; and (4) New fuel economy/carbon dioxide regulations could be delayed in the event of a macro slowdown |
| **Chevron** | We value CVX based on 2012 EV/EBITDA; we compress our target multiple from that derived from historical correlations between ROCE and EV/EBITDA. | Downside risks include commodity price volatility, adverse exploration and production results, and geopolitical risks from adverse tax and Production Sharing Contract (PSC) rates. |
| **Cognizant Technology Solutions** | Our $74 price target is a 50/50 blend of our base case and bull case valuations (which are blends of P/E multiples and DCF), to reflect potential upside to our estimates and associated multiple expansion. Our DCF uses a 9% WACC and a 4% terminal growth rate. | Downside risks to our price target: Cognizant earns roughly 41% of revenues from the cyclical financial services industry; cautionary comments by Cognizant's Tier 1 India-based peers (e.g. Infosys' recent mention of some short-term delays in contract signings/ramps) could weigh on sentiment. |
| **Colgate-Palmolive** | $101 price target represents 18x C2012E P/E, in line with CL's five-year historical average NTM P/E. | Pricing, currency movements, Venezuelan bolivar devaluation risk, oral care share, marketing expenses, cost savings, economic conditions, and commodity costs. |
| **Dollar Tree** | 16x (DLTR's 2012e P/E) applied to 2013e EPS, a slight premium to DLTR's 5-year average of 14.3x, which in our view is warranted for a mid-to-high teens EPS grower. | Traffic trends slow due to an overall weaker consumer. Lower sales could lead to earnings misses and impact valuation. |
| **Enterprise Products Partners** | Price target of $46 assumes 5.5% yield/5% distribution growth — i.e., yield stays stable and distribution growth is consistent with past track record and publicly disclosed management targets. | Economic slowdown causes severe demand destruction for NGLs beyond most bearish forecasts; preference for smaller-cap MLPs with higher expected near-term growth could cause rotation out of EPD and other large-cap diversified MLPs. |
| **Essex Property Trust** | Our $163 price target is a function of our estimates of forward NAV per share. | California's Proposition 13 (related to property taxes) never off radar screen. High exposure to California. |
| **IHS Inc.** | $96 price target derived from our 10-year DCF model using a WACC of 9.3% and a terminal multiple of 7.75x. | (1) Stagnation in organic growth due to lower renewal rates or new sales driven by lower energy prices, economic weakness, or shifts in customer demand. (2) High energy prices could pressure some customer segments where energy is a large cost component, whereas sharp drops in energy prices may impact business from small new drilling and producers. (3) Exchange rate fluctuations could impact revenue, as much of the business is conducted outside of the US. |
| **Oracle** | Investors currently appear to give ORCL little credit for acquired growth; we expect the multiple to return to 14x, the five-year average and below the most recent peak. | We believe the key risk to our target is increased execution risk from the large/unprecedented acquisition of Sun. |
| **Philip Morris International** | Our 12-month price target for PM of $75 is derived from a ~10x 2012e EV/EBITDA multiple and 14.7x P/E multiple, and is supported by our DCF valuation of $75/share (using a 7.8% WACC and a conservative assumption of 0.5% terminal growth in FCF). | The principal risks to the achievement of our price target include: (i) A prolonged slowdown in unit volume growth, which could raise legitimate questions regarding the long-term sustainability of PM's overall improved business algorithm; (ii) 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 more sensible; (iii) 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 (iv) significant strengthening of the US dollar versus PM's major currencies. |

*(continued)*

| Stock | Valuation Methodology | Risks |
|---|---|---|
| **Qualcomm** | Our $57 price target assumes QCOM's price-to-unlevered EPS ex-cash multiple holds steady at 13x, although as the company gains market share driving higher operating margins, we would expect multiple expansion. | WCDMA royalty rates could tick down as vendors seek renegotiation; pricing risk from 3G expansion in emerging markets; Investments into new projects (e.g., mirasol) might not pay off. |
| **RenaissanceRe** | Our $87 price target is based on 1.35x BV, a discount to RNR's historical average P/B of 1.6x, reflecting below cross-cycle ROE in a soft market. | EPS is more exposed to downside volatility from catastrophes; possibility of M&A given less success and lower returns outside its core property reinsurance markets. |
| **Schlumberger** | $105 price target based on ~13.9x 2013e EPS, below historical 12-month forward average of 26x. | Slowdown of global economic growth, triggering lower oil prices and broadly reducing global drilling activity; international margin expansion might continue to lag, especially if significant delays in larger production projects keep utilization lower than expected; potential market share loss as other service majors fill in possible gaps; acceleration in oil drilling in North America absorbs new pressure pumping capacity, bringing pricing to record levels; Large (~25%) exposure to North America. |
| **Target** | $64 price target assumes a 13.4x forward P/E (vs TGT's 3- and 5-year averages of 13-14x) applied to "core" 2012e EPS (excluding Canada and credit card dilution). | TGT shares could languish if core US comps falter. If the economy dips into recession, there is risk that Target's core comps could turn negative again. |
| **Teradata** | Our $65 base case price target assumes a 4x EV/sales multiple, near the low-end of the range for data center companies with similar growth due to Teradata's modestly lower margin profile. | Large deal sizes requiring C-level approval leads to lumpy quarterly results; margin pressure as customers renew support/license agreements; Increased competition could limit new customer growth, pressure pricing, and lower margins |
| **Union Pacific** | Our year-end price target of $105 is derived by applying a 13.5x Base Case multiple — in line with the recent historical average of 14x — to our 2012e EPS estimate. | (1) Legacy contract re-pricing can lead to surprise volume losses if too aggressive; (2) Contract renewals during 2010 were early in year, creating tough 2011 comps; (3) History of poor execution around volume rebounds could be risk for 2011/12; and (4) Capex likely to remain elevated for next few years as UNP continues to reinvest. |
| **United Technologies** | Based on a historical low-end multiple of 12x applied to the low end of the projected EPS range, 2014 earnings power (includes full Goodrich synergies) of ~$8 points to upside potential to $95 over the next 2 years. | A double-dip recession, major China setback, and/or further European dislocation could affect UTX's sales. Otis and Carrier are heavily weighted internationally (82% and 56% international, respectively) and are heavily levered to the global commercial construction cycle. We expect it's likely the markets will see more turbulence and UTX is not apt to be immune to short-term moves. Foreign exchange could also materially impact UTX's earnings as ~20% of sales are denominated in euros. |
| **VF Corp.** | Our $148 price represents be 13x our 2013 EPS estimate (the stock's 5 year average P/E). | Weak demand in Europe (~20% of revenue) could hinder Outdoor and Action Sports growth. Fluctuations in the Euro can impact operating results. VF could make risky acquisitions — VF has stated publicly that the company intends to continue to pursue acquisitions, though we have no knowledge of any impending deals. |
| **Visa** | Derived from a blend of P/E and DCF; reflects a gradual rebound in the P/E multiple, which is modestly below its 2-year average. Our DCF assumes a 7.9% WACC and a 4% terminal growth rate. | Potential catalysts/risks include: (1) more color on the F2012 outlook (and perhaps beyond) during Q4 earnings call; (2) merchant litigation settlement (possible in C3Q11, or several years later); (3) updates on investment levels/progress in key growth areas, and/or share repurchases; (4) news or indications regarding the Consumer Financial Protection Bureau's intentions; and (5) Visa Europe exercises its put to Visa, Inc. (unlikely in the next 12-24 months). |

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*(as of September 30, 2011)*

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| | Coverage Universe | | Investment Banking Clients (IBC) | | |
|---|---|---|---|---|---|
| Stock Rating Category | Count | % of Total | Count | % of Total IBC | % of Rating Category |
| **Overweight/Buy** | **1130** | **40%** | **457** | **46%** | **40%** |
| **Equal-weight/Hold** | **1168** | **42%** | **419** | **42%** | **36%** |
| **Not-Rated/Hold** | **112** | **4%** | **23** | **2%** | **21%** |
| **Underweight/Sell** | **400** | **14%** | **104** | **10%** | **26%** |
| **Total** | **2,810** | | **1003** | | |

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MORGAN STANLEY RESEARCH

**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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