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Vincent Farrell  
212-380-4909  
vfarrell@soleilgroup.com  
Harry Fong  
212-380-4856  
hfong@soleilgroup.com  
Edgar Roesch  
212-452-2941  
eroesch@jmsriver.com  
Gary P. Tenner, CFA  
770-476-4875  
gary@tennresearch.com  
A.J. Rice  
212-710-8915  
arice@pomeroyresearch.com  
Laura Martin, CFA  
917-373-3066  
laura.martin@media-metrics.com  
Michael Nelson  
646-456-6233  
mnelson@nelsonalpharesearch.com  
Jeffery Stein, CFA  
216-378-9650  
jstein@steinresearch.com

**Sales and Research**  
1-800-447-4318

**Trading**  
1-800-569-2407  
[www.soleilgroup.com](http://www.soleilgroup.com)

Lyle Gramley, Soleil's chief economist, recently wrote a piece about the first year of a recovery. He looked at nine prior recessions and found some interesting take-aways. The average recovery for the nine rebounds was 5.8% in the four quarters following the end of the recession. When the recession was deeper (an average of -2.7% for five of them) the recovery was more pronounced and showed an average gain of +7.1%. When less severe (four recessions with an average decline of -1.1%), the rebound was milder at an average gain of +4.1%. Net exports are usually a drag as the US recovers more quickly than the rest of the world, and inventory rebuild usually draws imports. Consumer spending is often a smaller part of a recovery than it would be for a normal economic period, but still critical. The key to the consumer segment is wage growth. Since wage and salary income is below a year ago, and since the consumer is still stretched and is in a conservative frame of mind, Lyle feels the recovery will be muted. Inflation usually goes down the first year of a recovery, so interest rates will stay low.

His conclusion in one sentence would be to expect a shallow recovery with low inflation. With this scenario, some stocks our analysts would focus on would be (in no particular order);

**Allstate (ALL, \$28.06, Buy)**

Harry Fong, Soleil, 212-380-4856

- Our Allstate (ALL-Buy) price target is \$34.00 which is pegged to a low 1.0x multiple of our projected 2009 year-end book value excluding AOCI of \$35.20.
- In a shallow growth economy with low inflation, Allstate should be a winner.
- The company's auto insurance business (2/3 of property casualty premiums) has actually been operating under "deflationary" environment for a number of years with above average returns on capital.
- Its underachieving life insurance business is now focused on returning to basics.
- The rollover impact of its large \$96 billion investment portfolio would improve with slightly higher interest rates while not subjected to much market value loss.
- The biggest risk is its commercial real estate portfolio (\$12 billion), but they invest principally in small projects with average loan size of just over \$12 million.

**Kellogg (K, \$46.66, Buy)**

**HJ Heinz (HNZ, \$37.79, Buy)**

Ed Roesch, James River Company, 212-452-2941

Kellogg

- Kellogg (K-\$46.66-Buy-TP\$53) generates 15% of sales in Latin America and Asia Pacific and 20% in Europe, giving the company better growth avenues if the U.S. recovery is slow.
- The company is driving toward \$1.85/share in cost savings by the end of 2011, among the highest in the group and 60% of our current-year earnings estimate.
- With cost inflation among the lowest in the group through June 2010 and with industry-leading levels of reinvestment already in the business (advertising and funding for productivity initiatives), we expect Kellogg's strong brands will allow it to hold onto more of those savings as earnings upside than most consumer products companies would.
- We believe Kellogg is worth 15.5 times our 2010 EPS estimate of \$3.40, or \$53.

Heinz

- Heinz (HNZ-\$37.79-Buy-TP\$45) generates 15% of sales in emerging markets and 34% in Europe, giving it better growth avenues if the U.S. recovery is slow.
- We believe Heinz is running a solid business, a fact that will transcend current price cutting/promotion by competitors in the important frozen entree category.
- We believe Heinz's projections of 7%-8% cost inflation or \$0.46 per share of foreign currency headwind for F2010 will prove conservative.
- We believe Heinz is worth 15.9 times our 2010 EPS estimate of \$2.83, or \$45.

**BB&T Corp. (BBT, \$26.12, Buy)**

Gary Tenner, Tenner Research, 770-476-4875

- Strong balance sheet will help to grow bank via the acquisition route even in the absence of strong national/regional growth
- Strong fee income stream (~42% of revenue) provides a stable base for BBT's revenue, offsetting credit costs in a difficult environment
- Recent FDIC-assisted acquisition of Colonial Bank provides a tailwind for 2010 EPS
- Our \$2.34 EPS estimate in 2010 equates to ROTE of 14.5%; we think that is worthy of a 2x multiple on 3Q10 TBV, for a \$30 price target

**Patterson Companies (PDCO, \$26.56, Buy)**

A.J Rice, Pomeroy Research, 212-710-8915

- Patterson Companies (PDCO- \$27) generates over 70% of its revenues from the dental supply market. Demographics favor this market as the population ages. Patterson could earn \$1.75 this year and \$1.92 next. We feel it is worth 18 times earnings out one year or \$34.

**CBS Corp. (CBS, \$10.03, Buy)**

Laura Martin, Media Metrics, 917-373-3066

- We recommend purchase of CBS in a low-growth, low-inflation environment based on the following analytical building blocks:
- CBS's largest asset, the CBS network, should have pricing power despite a low-growth, low-inflation environment owing to its limited advertising inventory (only 20 min/hour of ads) and dearth of competitors (only 3 other broadcast networks). CBS ratings are rising and current scatter advertising rates are up 25% y/y. The profit on each additional dollar of advertising revenue is about \$0.80.
- Cost cutting across all CBS divisions implies that as revenue growth turns positive with the economy (>70% of CBS's revenue is from advertising), EPS should overdeliver estimates. We expect CBS's FCF and dividends (currently at a 1.8% yield) to rise faster than S&P averages.
- CBS's historically low growth profile looks more attractive as other companies' growth slows.
- We expect CBS to continue to exit non-core assets like radio, publishing and outdoor, which creates an additional source of cash flow to repay debt or return to shareholders.
- Our Target Price of \$13 is an average of 4 forms of valuation: Discounted Cash Flow (DCF); Private Market Value; Target Price OIBDA Multiple; and Breakeven DCF.
- Risks to Target Price include: with about 70% of its revenue ad-driven, CBS is one of the most concentrated plays on advertising and particularly local advertising (with radio, TV stations and outdoor) under our coverage. Since advertising is linked to the economy, if economic expansion does not occur, CBS's EPS estimates may have to be lowered.

**CenturyTel (CTL, \$31.87, Buy)**

Mike Nelson, Nelson Alpha Research, 646-456-6233

- We like CenturyTel Inc. (CTL- \$31.87.) The company has a strong balance sheet, solid free cash flow, and an 8.6% dividend yield supported by a low dividend payout ratio of just 52%. The recent Embarq acquisition will allow expense cuts as well. Target is \$40 which would be 7 times free cash flow, in line with the group average.

**Big Lots (BIG, \$24.57, Buy)****Jo-Ann Stores (JAS, \$26.44, Buy)**

Jeff Stein, Stein Research, 216-378-9650

## Big Lots

- Big Lots (BIG-Buy) value focused consumer will continue to drive more footsteps into their stores producing growth in market share in a contracting retail space.
- Company is getting better brands in its stores as vendors seek alternative channels of distribution to grow their businesses.
- BIG faces easy comparisons and value proposition should stand out as industry inventories are more properly aligned with demand
- Company has strong debt-free balance sheet to take advantage of low cost real estate opportunities for future growth.
- Target of \$32.00 assumes 16.0x P/E on FY10E of \$2.00 and 7.6x EV/EBITDA. The historic P/E and EV/EBITDA by comparison are 17.5x and 6.7x respectively.

## Jo-Ann Stores

- Jo-Ann Stores is the beneficiary of consolidation in its space and propensity for consumers to seek closer to home leisure activities.
- Wal-Mart is withdrawing from fabric category, producing an estimated \$800 million sales opportunity. Michael's is leveraged due to 2006 LBO and focused on debt repayment.
- Company has increased direct sourcing, enhancing merchandise margin. Expenses have been relatively flat producing SG&A leverage opportunity as sales continue to grow.
- Potential for mid-single digit EBIT margins could yield earnings power of \$2.50-\$3.00.
- Price target of \$34.00 assumes an EV/EBITDA multiple of 6.3x, consistent with 10-year moving average.



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By: Michael Nelson

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For further discussions of risks and valuations pertaining to the above-mentioned rated companies with price targets, please see our latest reports on these individual companies, available by contacting the analyst at the address/phone number above.

### Companies Mentioned

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- Big Lots (BIG, \$24.57, Buy, NYSE)
- CBS Corp. (CBS, \$10.03, Buy, NYSE)
- CenturyTel (CTL, \$31.87, Buy, NYSE)
- H.J. Heinz (HNZ, \$37.79, Buy, NYSE)
- Jo-Ann Stores (JAS, \$26.44, Buy, NYSE)
- Kellogg (K, \$46.66, Buy, NYSE)
- Patterson Companies (PDCO, \$26.56, Buy, Nasdaq)

### Additional Disclosures

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