12 Top FTSE 100 Stocks: Buy, Sell or Hold?

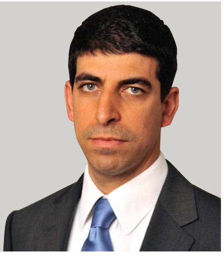
0117 900 9000 | www.hl.co.uk | November 2013

Panmure Gordon & Co

DAVID BUIK, MARKET COMMENTATOR, PANMURE GORDON

In his own words David "has spent 51 years in the City of London, relatively gainfully employed by Philip Hill Higginson Erlangers and then as a money broker, with his halcyon days being spent at Exco, Prebon Yamane and BGC Partners. He is deeply and irrevocably committed to the City of London and is seeing out the twilight days of his career as a market commentator for Panmure Gordon & Co."

FT



OLIVER RALPH WRITER FOR FT LEX COLUMN

Oliver Ralph joined the Financial Times' Lex column in June 2012. Prior to that, he spent three years as the FT's UK companies editor. Before joining the FT in 2009, he spent ten years at Investors Chronicle where his positions included companies writer, news editor and editor.

Hargreaves Lansdown

RICHARD HUNTER (interviewer) **HEAD OF EQUITIES, HARGREAVES LANSDOWN**

Richard Hunter joined Hargreaves Lansdown Stockbrokers in November 2004, having previously worked at NatWest Stockbrokers. With over 25 years' stockbroking experience he has become one of the industry's most quoted figures in the national press, making regular appearances for the BBC, ITV, CNBC, Bloomberg, Sky TV and national radio. As Head of Equities, Richard provides regular share research and analysis on our client's most popular holdings.

Today we are going to analyse the investment case for some of the shares which are most popular with our clients, including BSkyB, Aviva, RSA Insurance, Vodafone, Lloyds, Tesco, Sainsbury, BP and Shell, all stocks facing very interesting challenges and opportunities. Helping us with this examination are two extremely experienced market commentators. Firstly it is a great pleasure to welcome David Buick. David has over 50 years' experience in the city and is currently a market commentator for Panmure Gordon, one of the leading and longest-established institutional brokerages in the city. Alongside him is Oliver Ralph. Oliver has written for the Financial Times Lex column since June 2012 and prior to that spent three years as the FT's UK companies editor.

So let's kick off with BskyB, a share recently in the news after taking a big hit after BT Sport won the exclusive right to broadcast European football. David is this the beginning of a slippery slope for Sky?

David Buik: You always get an overreaction to a little bit of news. You have got to remember Sky has over 25 years' experience in pay-to-view sports broadcasting and only 3% of its business was involved in European football. Of course most analysts are worrying about what is going to happen in 18 months' time when the Premier League football rights are up for grabs - that is a very big contract.

Sky is smarting and this 15% reduction in the share price may be an opportunity for investors. I don't believe that Sky will give up the ghost by any stretch of the

This transcript is not personal advice based on your circumstances. If you are unsure about the suitability of an investment contact us for advice.

Hargreaves Lansdown

One College Square South,
Anchor Road, Bristol, BS1 5HL
www.hl.co.uk

imagination. Also - and I am purely speculating here - Vodafone now has loads of money following the sale of Verizon Wireless. What are they going to do with this cash? They have already bid for Kabel Deutschland, which is pretty small beer for Vodafone. However if they see another way of making money through the world of entertainment and media, Sky might fit very neatly into its pocket. So overall I think there has been an overreaction - the brand is good and it will recover.

Oliver, Vodafone is another share that our clients hold quite widely. Following the news that Vodafone is selling its 45% stake in Verizon Wireless to Verizon Communications (a deal expected to complete next year) and vague bid speculation from AT&T, what are your current views on the company?

Oliver Ralph: Vodafone has had a very busy year on the merger and acquisition front as you mentioned. But putting that to one side, things are tough for Vodafone. Like all European mobile operators there is a lot of pressure on the amount they can charge. David Cameron recently made more comments about trying to cut mobile bills, so there's real pressure on revenues for Vodafone, particularly in Europe. Outside Europe it is doing fairly well.

Given this pressure on revenues it might look to deploy some of its cash in trying to find new ways to grow its revenues. However it's really tricky. That is why we have seen BT spending big on football rights - it is trying to bring more people in to see its content. Just providing the pipe isn't enough any more.

Does Vodafone become a takeover target once the Verizon stake is out of the way?

Oliver Ralph: Yes, I think it does, particularly for a big telecoms operator like AT&T. It has got a good spread of mobile businesses and if you wanted an easy way in to a wide spread of mobile operations, Vodafone would appear to be a good one to go for.

David, moving on to the supermarkets, what are your current views on Tesco and Sainsbury's?

David Buik: I am a big Tesco fan, but they have had a torrid time. When Phil Clarke took over from Terry Leahy it looked like he had been handed a hospital pass. In the last two years Tesco's share price has dropped by about 10% whereas Sainsbury's is up by around a third. Sainsbury's have had 35 consecutive quarters of like-for-like sales growth and that has not been the case for Tesco. Tesco have had some awful investments in California, where they probably lost the best part of $2 billion, and they took their eye off the ball in the UK. Phil Clarke has had to restructure the company, but we shouldn't forget they have still got 30% of the market and providing they get a grip of the marketing situation it's a big and strong enough company to make some really good inroads in China and the Far East. That said they are probably going to struggle in places like Eastern Europe.

As for Sainsbury's, it's a very strong model, underpinned by Qatar having a very strong stake in it. Its results last week were very good but in terms of the competition in the street, but I am not wildly excited about supermarkets. There is a decent dividend but with margins under so much pressure where is the increased level of profitability going to come from? Justin King says it's easy - you just have to be light on your feet. I have my doubts because everybody is in that market now and the margins are razor thin.

Oliver, where is growth likely to come from for the likes of Tesco and Sainbury's?

Oliver Ralph: They are all trying everything they can. Tesco has tried overseas ventures, some of which have worked but many haven't. In non-food in the UK it went big into consumer electronics. That market turned out to be very, very competitive as you had all the online retailers coming in with much cheaper prices than Tesco could offer. As a result it scaled back its consumer electronics operations although it has recently launched its own tablet computer. It also has various other online services.

Tesco is really trying to revamp its stores by making them bigger and trying to make them more welcoming. They have bought the Giraffe chain of restaurants and have invested in a chain of coffee shops. It is introducing these into its stores in the hope of making them a more pleasant place to come. There is a pilot store in Watford and the company is reporting some sort of sales uplift in these reshaped stores.

However, the problem is that the pricing of food is what drives the business. The two really successful chains today are Aldi and Lidl, the two big discount food retailers. The question is whether Tesco's efforts can really make up for that very tough price competition.

Moving on to the banking sector, we see a lot of clients trading these stocks rather than investing in them, because they have been so volatile. David, focusing on Lloyds for the moment, are there signs they are maybe turning the corner?

David Buik: I think we have really got to go back to 2008 when that terrible deal to put HBOS together with Lloyds (which was insane in hindsight) happened. The due diligence was done with indecent haste - I will never know whether it was to placate Gordon Brown and the government from having three banks in the recovery room. That's probably the case, but bearing in mind that Antonio Horta-Osorio has done an excellent job in my opinion, showing great skill at Santander with the retail market, he clearly understands it. I don't think anybody knew the size of the PPI bill. I think Lloyds has shaken out something like £8 billion in repaying some of these PPI demands which was pretty substantial, so Lloyds's balance sheet is beginning to look pretty clean.

We don't think they are involved in the foreign exchange manipulation and so you would hope that now that they have given the government back a little bit their share price might go forward. I think an awful lot depends on the UK economy. If the UK economy is going to pick up, say 2.8% next year, which the inflation report last week said it would, then I think Lloyds is a good bank to be on. However it doesn't excite me as a share to the same degree as perhaps Barclays does.

So presumably the fact that, as David rightly says, Lloyds is often seen as a UK economy play, that's got to be a good thing for it in the medium term?

Oliver Ralph: If the UK economy recovers, the question for an investment is whether it is worth going into the shares. The shares have had a great run over the past year. I think they are up by two thirds or so and that has made them look very, very fully valued. They are on about 1.4 times their book value; that's on a level with HSBC with all its great emerging market exposure, and only slightly less than Standard Chartered, which is also a very emerging-markets focused bank. So that 1.4 times book value is way ahead of what most European banks trade at. I think if there is any growth to come out of Lloyds that's priced into the shares at the moment.

As for the potential for a dividend, Lloyds is very keen to pay one and they are discussing with the government whether they will be able to do that. For me it's a bit too early to be thinking about a dividend: Lloyds are still making more provisions for PPI. We don't know when that will stop: they hoped the top of it would be last year, then they said "this year, maybe it's next year, maybe it's the year after". It's hard to imagine that there is anyone in this country who doesn't know they can claim for PPI but there is still some uncertainty on that as well as on capital rules. We don't know exactly where some of the details are going to settle and, of course, if the UK economy does grow Lloyds will need to put capital behind funding all that extra lending it might be able to do. So I think it is perhaps too early to be thinking of this really as a dividend stock.

So, in terms of geographically diversified UK banks, Barclays are certainly up there, presumably HSBC as well?

Oliver Ralph: Yes. Although it is based in the UK, it's really a global bank with a lot of activity in Asia and a lot in Europe. If you are thinking about HSBC you have really got to see it as a play on the global economy, particularly global trade flows. It has been reshaping its portfolio pulling out of less profitable areas and, again, it's quite geared to the economic recovery. But if Asia struggles a little as it has done this year then that's not good for HSBC.

Picking up on Barclays, David, it seems as though every time a regulatory consolidation or consultation comes along, Barclays is involved one way or the other, be that FX, interest rate swaps, asset stripping . . .

David Buik: I think that's true but the amount they have been involved in is rather less than some of the other players. Although I suspect Oliver may profoundly disagree with me, I think foreign exchange manipulation is going to be very hard to prove when you have got hundreds of thousands of players in the FX market.

Barclays has shaken the trees and I hope that most of the bad stuff is already out in the open. The recent £5.8 billion rights issue was not brilliantly handled, but it wasn't too bad. What I particularly like about Barclays is the fact that its brush is much broader than Lloyds. Recently it has picked up some corporate finance activity: it was on the ticket for Royal Mail, it was on the ticket again for Merlin Entertainment and it's also a tremendous bond issuing house. The company is really focusing on putting its customers first and I would be hopeful that the share price would be much better in a year's time or 18 months' time than now.

Everyone's favourite sector now: insurance. Aviva and RSA Insurance are both widely held amongst our clients but, Oliver, RSA are having somewhat of a hard time at the moment?

Oliver Ralph: That's to put it mildly. To paraphrase, to release one profit warning a week is a misfortune; to release two looks like carelessness, particularly when one comes after the close of business on Friday evening. Two profit warnings in a week for very different reasons. The first reason was partly weather-related. As an investor in insurance companies, you have to expect that sometimes there will be claims. That's part of the risk and reward of investing in an insurer, although admittedly the insurer could reinsure some of that risk.

The other one looks like mismanagement in the Irish business: questions about the reserving policy and the profit recognition policy. That's something that RSA should have had much better control on. Ireland has been a great growth story but perhaps that growth has come at a big cost. Now there are big questions over the chief executive. He cut the dividend earlier in the year at the full year results in February. So investors were already very unhappy with what he was doing, although I happen to think he was right to cut the dividend: he wanted to invest in growth markets, which I think is the right thing to do. However there were questions over him and now there are these two profit warnings in a week. He has got a very tough job on his hands.

Aviva, rather like Tesco, has got a pretty large transformation plan going on at the moment. It also suffered something of a drop earlier this year when it announced its dividend cut, which with hindsight was probably the right thing to do. Even at the lower dividend rate it is still a fairly punchy yield. Is Aviva moving in the right direction do you think?

Oliver Ralph: It's moving in the right direction, but like a tanker. It turns around very slowly: it's choosing its markets; selecting which it wants to be in and which it doesn't; cutting a lot of costs; and changing its internal capital structure, which should help an awful lot when it comes to being able to pay dividends. But it's going to take a long time to turn it around, and at the end of that the company really has to prove there is some growth.

A lot of its operations are in the UK and Western Europe and these are not great growth markets for insurance, so it's got to prove that it can get growth in these markets and also expand to more exciting places. So, yes, there is a bit of a turnaround going on, but it will take a while and then there is the big question of where next.

And what are your thoughts on the insurance sector, David?

David Buik: I endorse pretty much what Oliver has said about RSA. I think Mark Wilson, the recently appointed chief executive of Aviva, has made all the right noises saying "I don't like this, and I don't like that" and he is telling the market "we will do something about it". I have to endorse again what Oliver says about it being too domestically orientated. At the moment there is no international business that they are getting hold of.

When the fund management business for Aviva is good, it's very good, but we have come a long way in the last four years and how much further there is to push on in this and make real profits remains to be seen. In addition, the insurance market is breathtakingly competitive in this country. It doesn't matter whether it's motor, life or anything. I would like him to come back to the rostrum and step up to the plate two or three more times before I got excited about buying the shares. That really is reflective of what Barrie Cornes, Panmure insurance analyst, believes.

And in the meantime presumably there are better places within the sector to be looking at?

David Buik: Oh, yes. In particular Barrie Cornes has flagged up Prudential, which last week produced some pretty interesting numbers. What I think is fantastic is what you can see from the flow of business at the Pru. It's not that many years ago when Mr Thiam, the chief executive, decided he would like to buy AIG in Asia for $40 billion or whatever it was. It cost the company £250 million to pull out of the deal. He has got every right to turn round and say "there you are, I told you so", because the Asian business is gangbusters.

If you compare Prudential's price/earnings ratio (P/E) to AIG in Asia, Prudential's stock should be around £18 and it's well short of that at the moment. Their business in the last quarter went up 20% in Asia, 9% in the United States, down 10% in the UK, which is interesting. Prudential's got a very broad brush that Panmure Gordon's Barrie Cornes likes very much indeed.

Oliver, historically, amongst the companies we could always rely on for a high dividend, was BP. There was also the market adage "never sell Shell",

so presumably things continue to go well for the oil companies?

Oliver Ralph: Well, not quite going so smoothly for either BP or Shell at the moment. BP has been in the news over the past couple of years and the twin issues that have driven news flow at BP recently are still there. Firstly, it's still finishing off the court cases related to the Macondo oil spill. There is a big question of whether it will be proven gross negligence, which would cause another very large pay-out. BP is still paying out from its compensation fund so if it is proven that gross negligence was the case here then that could have implications for its ability to operate further in the Gulf of Mexico.

The other issue it has is on the other side of the world, in Russia, where it has swapped its 50% stake in TNK BP, its problematic joint venture. It now has a 20% stake in Rosneft, which should work out much better. Rosneft is very well connected with the government and should give BP access to some of the new exploration regions in the Arctic Circle. But BP has got to prove that was a good swap: that all the production that came with TNK BP is worth swapping for the potential of a 20% stake in Rosneft. So that's the other big challenge that it has got coming up.

Shell also has challenges ahead. It's had a very quiet few years, particularly compared to BP. But it still has problems in the US, where it has invested a lot of money in shale which hasn't really paid off yet, and in Nigeria, where it's got various operational problems. So things are not smooth there either. There is a new chief executive coming in shortly and it will be interesting to see what his strategy is.

David, it is such an immense sector to try and look underneath the bonnet. Whenever there's any update in terms of refining margin, for example, they have both been under the cosh recently. However both BP and Shell offer an attractive dividend yield. What are your current thoughts on the oil sector?

David Buik: I keep going back to Lord John Browne's days. I think I am right in thinking that BP paid out £8.5 billion in a dividend every year. Every single pension fund wanted BP shares for that reason: it was such a good little earner. However its fortunes have changed dramatically. The one thing I think it has going for it is Bod Dudley's appointment, which I thought initially injudicious.

I think Bob Dudley has got a chance. BP employs something like 30,000 people in the United States. The political help they have received from the president and from others has been nothing short of disgraceful. If anybody is going to help sort it out, I think it is going to be an American and I think Bob Dudley is very well connected. The reasons why I thought the appointment was odd was because he hadn't got on with TNK people in Russia and now he is nicely bedded down with Rosneft. As Oliver says, Rosneft is a much better connected company on a recovery mission.

And taking Oliver's point, and he is dead right, Shell has been as an investment a deeply boring company when you consider how much money you have made in other sectors in the course of the last five years. BP has been no better as a performer, but on a recovery mission our company would rather be with BP than it would be with Shell.