

## CONTENTS

**Market View** : Strong corporate earnings and tighter CDS spreads push the market higher

**Barclays** : Full year results beat market expectations

**Kerry Group** : Swiss peer Givaudan reports results

**Company Note** : Bank of Ireland

**Market Movers**

## IRISH PAPERS TODAY

EU finance ministers impose 28-day deadline on Greece  
*(The Irish Times)*

Ireland not like Greece, Lenihan tells EU  
*(The Irish Times)*

Coughlan caves in on O'Leary jobs talks  
*(Irish Independent)*

## INTERNATIONAL PAPERS TODAY

Brussels raises pressure on Athens  
*(Financial Times)*

Nokia and Intel plan mobile link-up  
*(Financial Times)*

EU wary of more Greece support  
*(The Wall Street Journal)*

## Market View

**Analyst : Stephen Taylor**

European equity markets are stronger this morning following gains in Asia overnight and better than expected results from Barclays (discussed below) this morning. Credit Default Swaps (CDS) for peripheral European nations are also tighter this morning indicating that in the short-term concerns surrounding sovereign debt have receded somewhat. Yesterday, European Finance Ministers told Greece to take further deficit measures by March 16<sup>th</sup> in order to reduce their budget deficit to 8.7% in 2010 from 12.7% last year. Eurogroup Chairman Jean Claude Juncker said that if the Greek government's efforts do not satisfy the commission, the EU will impose additional measures. Over the weekend, US investment group Blackrock said that it believes fears around Greece are overdone and that it has an overweight position on Greek bonds. As for today the main focus will be on economic data. UK CPI data is expected to show a strong increase. In Germany, the market will be looking closely at business confidence figures in the form of the ZEW reading. Expectations are for a sizeable decline in February to a reading of 41 from 47.2 previously. With data out of Europe disappointing recently, it will be important for equity markets that this number comes in ahead of expectations. In the US, Empire Manufacturing data is expected to show further improvements. In general, manufacturing data in the US has surprised to the upside and we expect a further positive outcome from today's figure. On the earnings front, earnings from Kraft and Abercrombie and Fitch are due to be release before the US market opens.

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**Barclays : Buy**      **Previous Close** 275p      **Target** 415p      **Analyst** Oliver Gilvarry

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Barclays released full year results this morning beating market expectations. Full year net profit was £9.4bn compared to the market expectation of £8.6bn. The beat was helped by higher revenues and lower impairment charges. Impairment charges for the year came in at £8.1bn, compared to management guidance earlier in the year of £9bn. Management now expect a moderate impairment decline overall with some increases in certain areas, particularly commercial lending. The group looks to have experienced the peak in impairments in 2009. UK Retail Banking reported a PBT of £612m which was impacted by lower Net Interest Margins (NIM) due to the higher cost of deposits plus impairments on the loan book. The main drivers of impairments were consumer lending and current accounts. Mortgage impairments remained low. The group continued to grow the loan portfolio by 3.46% to £62.7bn. Barclaycard reported PBT of £761m offset by higher impairments charges, but the rate of increase was lower than on H1. Revenues in BarCap were £17.862bn, slightly ahead of expectations with a miss in FICC offset by better than expected equity revenues. Costs to net income were better than expected at 73% for the year, offsetting the poor result in Q3. On capital the group reported core tier 1 of 10% higher than expected due to lower Risk Weighted Assets (RWA). RWA for the year were £383bn lower than the circa £405bn expected. The decline was due to currency moves and a reduction in the size of the balance sheet, with an active reduction in derivative balances. Tangible Net Asset Value (TNAV) for the year was also higher than expected at £3.37 and a final dividend of 1.5p was announced. Management were positive on the outlook for 2010. Run rate on a PBT basis is stronger so far compared to 2009. The result this morning were very strong and delivered in areas such as capital, impairment charges and BarCap turnover where the market was concerned. We maintain our BUY rating on the stock. An investor presentation will be held at 9.30 this morning.

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**Kerry Group: Buy**      **Previous Close** €21.55      **Target** €22.50      **Analyst** Oliver Gilvarry

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Givaudan's, Swiss flavours maker and international peer of Kerry group, has reported full year results this morning. Net profit for the period rose to CHF199m, from CHF111m a year earlier and in line with market consensus estimates. In terms of outlook Givaudan expects to outgrow the underlying market thanks to its strong product pipeline. In addition, it is confident it can achieve its savings target of CHF200m by 2010 and return to its operating margin level of 23% by the end of the year. It has proposed a final dividend of CHF20.60, better than analysts' forecasts of 19.43 francs. Kerry group remains our preferred play in the sector and we are buyers of the stock ahead of its full year results announcement on February 23<sup>rd</sup>.

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# Bank of Ireland

## BUY

Previous Close : €1.22

Price Target : €1.50

16th February 2010



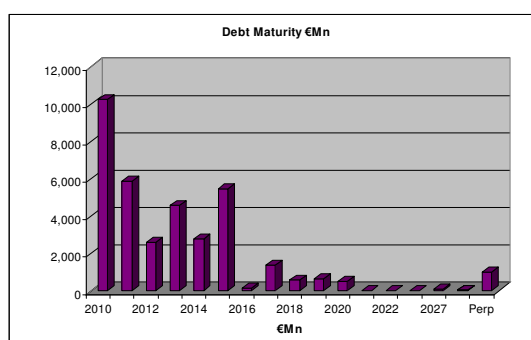
Analyst : **Oliver Gilvarry**

- With NAMA moving towards a conclusion with loans to begin moving in the next number of weeks the recapitalisation and the restructure of the Irish banking system will follow shortly. Bank of Ireland (BKIR) will not be immune to these changes and faces a number of difficult challenges in the years to come. For example we expect the decline in Net Interest Margins (NIM) to continue in 2011, but this will be trough year. Margins will begin to pick up in 2012 to 1.52% as the economy recovers and more normalised pricing for BKIR debt will be available following recapitalisation. Part of the reason for these declines will be the higher cost of refinancing the €10bn of maturing term funding this year plus the continuing competition for deposits within the Irish system.
- Lower NIM during the next two years will impact on operating profit in the group, which only in part will be offset by a reduction in the cost:income ratio. Cost:income ratios in the group over the last number of years have been on average 57%. Management will in our opinion look to reduce this over the next two years by further cost cutting with staff reductions part of this. This reduction will lower the cost:income ratio to 53% by 2012.
- Loan growth will remain weak over the next two years as the Irish consumer will be reluctant to borrow and we estimate loan growth in only the Irish mortgage and the SME books over the next two years. Property portfolios will continue to contract and consumer lending will also be weak. The loan book will fall by 14% to €117bn by 2012 including the transfer of loans into NAMA.
- Pre-provision profits of the group will fall to a low of €1bn due to the pressures of lower margins and a falling loan book, but offset by better cost:income ratios. The impact from the loss of performing loans to NAMA will be offset by the coupons receivable on the NAMA bonds.
- On impairments, we estimate the bank will have impairment charges of circa €8.4bn of the loan book including transfer to NAMA and impairments on other parts of the loan book between 2009 and 2012. The lack of strong operating profits due to a declining loan book and falling NIM will result in the group remaining loss making till 2012. A larger driver of impairments in FY 2011 will be the impact from NAMA.
- The Minister for Finance guided the system wide average discount would be 30% in September, but given the delay in implementing NAMA this average in our opinion will move higher. We still believe BKIR's haircut will be lower than others in the Irish system due to a better quality loan book, but it will still be 27%. This will result in a €2.5bn impairment charge in FY2011 relating to NAMA. Provisions of circa €1.4bn have already been taken by the group on loans moving to the agency.
- The sensitivity of the group to NAMA can be seen if we estimate the haircut to be in the range of 45%, with an impairment charge over the same period of €11.2bn, 1.3x greater than our base case.
- Once the loans move from the balance sheet, the weak economic conditions will mean impairment charges on the residual portfolios will be high. Impairment charges on the SME and Corporate portfolios will be 4% between 2010 and 2012 with consumer loan losses of 10.5% in the same period.
- Given the problems facing the group outlined above, a significant capital raise will be required. The requirement for higher capital levels hits the Irish banks at the time they are working through the collapse of the Irish property market. We believe the capital ratio needed by BKIR is 7.00%, requiring a capital raise of €2.9bn. Part of this requirement will be financed in part from buyback/conversion of hybrid debt, which has already begun with the announcement last week. The current buyback raised €405m plus we have modelled another €578m following a buyback/conversion of Tier 1 and Upper Tier 2. This will reduce the capital requirement to €1.9bn.
- This level of capital is 1.5x the bank's current market cap, making it extremely difficult for the group to raise all of this from the market. We expect the capital will be raised from conversion of part of the Government preference shares resulting in State Ownership moving towards 40%, assuming the Government convert the preference shares into ordinary equity at current market prices.
- We do not rule out the possibility of the group raising some of its capital requirement from the market, but the full amount in one transaction will be difficult. Any private capital raise will be a positive for the stock as it will limit dilution compared to our analysis here.
- Under our extreme scenario of a haircut of 45%, the capital raise is significantly higher, with almost €5bn of capital needed or 4x the current market cap. As we discuss below this has a significant impact on shareholder dilution.
- Tangible Net Asset Value (TNAV) of the group will fall from current levels following the dilution due to an increased share base. Under our base case scenario, TNAV hits €1.55 in 2011 moving to €1.70 in 2012. Under our extreme scenario we have TNAV of €0.84 and €0.89 in the same period as the capital requirement will be more dilutive to shareholders.
- With low levels of ROE generated by the group plus lack of growth in the loan book over the next two years, valuation of the group must be based on a discount to TNAV as the group will struggle even in our base scenario to generate ROE significantly above 10% even after 2012. With such a low ROE the shares should trade a 15% discount to TNAV, when based on FY2012 TNAV gives a price target of €1.50.
- Under our extreme case, the ROE will be so low compared to the bank's current cost of equity of 17.80%, the TNAV multiple would be 0.5x or €0.45.
- The outcome of the haircut placed on the loans transferring into NAMA is key determinant of our valuation. For example each 1% fall in the haircut; it adds 8c to the TNAV in 2012. On an opposite move, it reduces the TNAV by 7c.
- Despite the uncertainties surrounding the bank we place a BUY recommendation on the stock, but it is high risk with a large number of variables both domestically and externally that will impact the stock. Based on our assessment, we believe our base case is more probable, but our extreme scenario highlights the risk to the shareholders value if NAMA haircuts move above 30% or economic conditions in Ireland deteriorate further.

### Key Company Info

| Descriptive Stats |             | Shareholders          |              |
|-------------------|-------------|-----------------------|--------------|
| Year to date      | -7.09%      | Harris Associates     | 8.04%        |
| 52 Week High      | 3.50        | Bank of Ireland Asset | 2.99%        |
| 52 Week Low       | 0.12        | Irish Life            | 2.99%        |
| Reuters           | BKIR.I      | Capital Research      | 1.58%        |
| Bloomberg         | BKIR ID     | Capital Research & Ma | 1.00%        |
|                   |             |                       |              |
|                   | <b>FY09</b> | <b>FY10e</b>          | <b>FY11e</b> |
| Revenue €m        | 3,670       | 2,109                 | 1,737        |
| Pre Tax profit    | -7          | -1,071                | -2,743       |
| DPS               | 0.00        | 0.00                  | 0.00         |
| Div Yield         | 0.00%       | 0.00%                 | 0.00%        |

### Funding Profile & Loan Book





## International Equity Markets

| Index     | Value  | 1-Day | YTD   |
|-----------|--------|-------|-------|
| ISEQ      | 2,863  | -1.4% | -3.0% |
| FTSE      | 5,167  | 0.5%  | -3.5% |
| Dow Jones | 10,099 | -0.4% | -3.2% |
| S&P       | 1,076  | -0.3% | -3.6% |
| Nikkei    | 10,013 | -0.8% | -4.9% |
| Stoxx 50  | 2,684  | 0.4%  | -8.6% |

## Sector Performances

| Sector       | Index | 1-Day | YTD   |
|--------------|-------|-------|-------|
| Construction | 249   | 0.1%  | -9.2% |
| Technology   | 186   | -0.3% | 1.7%  |
| Oil & Gas    | 317   | 0.4%  | -3.5% |
| Financials   | 198   | 1.0%  | -9.2% |
| Retail       | 244   | -0.4% | 0.5%  |
| Food & Drink | 301   | -0.4% | -0.7% |

## Commodity Prices

| Commodity | Index   | 1-Day | YTD   |
|-----------|---------|-------|-------|
| Crude Oil | 74.1    | -1.5% | -6.5% |
| Copper    | 310.2   | -1.6% | -4.9% |
| Gold      | 1,101.1 | 0.7%  | 1.7%  |
| Silver    | 15.4    | -0.9% | -6.0% |
| Wheat     | 501.3   | -1.4% | -8.1% |
| Cattle    | 90.8    | -0.8% | 1.8%  |

## Currency Exchange Rates

| Currency | Index   | 1-Day | YTD  |
|----------|---------|-------|------|
| €/\$     | 1.360   | -0.2% | 4.8% |
| €/£      | 0.868   | 0.0%  | 1.9% |
| £/\$     | 1.566   | -0.3% | 2.9% |
| \$/JPY   | 90.010  | 0.0%  | 3.5% |
| €/JPY    | 122.380 | -0.2% | 8.4% |
| €/SFR    | 1.466   | 0.0%  | 1.2% |

## 5Yr Credit Spreads

| Product      | Index | 1-Day | YTD   |
|--------------|-------|-------|-------|
| Invest Grade | 90.4  | 1.6%  | 31.8% |
| High Yield   | 518.7 | 1.8%  | 20.4% |
| Financials   | 97.5  | 1.2%  | 43.2% |
| BoI          | 234.7 | 1.1%  | -4.7% |
| AIB          | 251.1 | 2.7%  | -8.7% |
| RBS          | 165.2 | 1.4%  | 19.2% |

## Money Market Rates

| Rate      | EUR  | UK   | US   |
|-----------|------|------|------|
| Overnight | 0.3% | 0.5% | 0.2% |
| 3-Month   | 0.7% | 0.6% | 0.3% |
| 1-Year    | 1.1% | 1.0% | 0.5% |
| 2-Year    | 1.5% | 1.6% | 1.1% |
| 5-Year    | 2.5% | 3.1% | 2.7% |
| 10-Year   | 3.4% | 4.0% | 3.8% |

| Date       | Company                           | Region | Event   |
|------------|-----------------------------------|--------|---------|
| 16/02/2010 | Abercrombie & Fitch Co.           | US     | Q4      |
| 16/02/2010 | Genuine Parts                     | US     | Q4      |
| 16/02/2010 | Kraft Foods                       | US     | Q4      |
| 16/02/2010 | Aéroports de Paris SA             | FR     | TRAFFIC |
| 16/02/2010 | Deutsche Boerse AG                | DE     | PRELIM  |
| 16/02/2010 | Fiat SpA                          | IT     | RESULTS |
| 16/02/2010 | Novestra AB                       | SE     | Q4      |
| 16/02/2010 | Barclays PLC                      | GB     | PRELIM  |
| 16/02/2010 | Intercontinental Hotels Group Plc | GB     | PRELIM  |
| 16/02/2010 | Premier Foods Plc                 | GB     | PRELIM  |
| 17/02/2010 | Analog Devices                    | US     | Q1      |
| 17/02/2010 | Deere & Co.                       | US     | Q1      |
| 17/02/2010 | Hewlett-Packard                   | US     | Q4      |
| 17/02/2010 | Devon Energy Corp.                | US     | Q4      |
| 17/02/2010 | BNP Paribas SA                    | FR     | FINAL   |
| 17/02/2010 | Euler Hermes SA                   | FR     | FINAL   |
| 17/02/2010 | PUMA AG Rudolf Dassler Sport      | DE     | FINAL   |
| 17/02/2010 | ING Groep NV                      | NL     | Q4      |
| 17/02/2010 | Assura Group Ltd                  | GB     | TRADE   |
| 17/02/2010 | Thorntons PLC                     | GB     | INTERIM |
| 17/02/2010 | Legal and General Group PLC       | GB     | NEW BIZ |
| 17/02/2010 | Acergy SA                         | GB     | FINAL   |

| Date       | Event                         | Region | Estimate |
|------------|-------------------------------|--------|----------|
| 16/02/2010 | CPI (MoM)                     | UK     | --       |
| 16/02/2010 | RPI (MoM)                     | UK     | --       |
| 16/02/2010 | DCLG UK House Prices (YoY)    | UK     | --       |
| 16/02/2010 | ZEW Survey (Econ. Sentiment)  | GE     | --       |
| 16/02/2010 | ZEW Survey (Econ. Sentiment)  | EC     | --       |
| 16/02/2010 | Empire Manufacturing          | US     | --       |
| 16/02/2010 | ABC Consumer Confidence       | US     | --       |
| 17/02/2010 | Bank of England Minutes       | UK     | --       |
| 17/02/2010 | ILO Unemployment Rate (3mths) | UK     | --       |
| 17/02/2010 | Construction Output SA MoM    | EC     | --       |
| 17/02/2010 | Euro-Zone Trade Balance       | EC     | --       |
| 17/02/2010 | MBA Mortgage Applications     | US     | --       |
| 17/02/2010 | Import Price Index (MoM)      | US     | --       |
| 17/02/2010 | Housing Starts                | US     | --       |
| 17/02/2010 | Building Permits              | US     | --       |
| 17/02/2010 | Industrial Production         | US     | --       |
| 17/02/2010 | Capacity Utilization          | US     | --       |
| 17/02/2010 | Minutes of FOMC Meeting       | US     | --       |
| 18/02/2010 | Public Sector Net Borrowing   | UK     | --       |
| 18/02/2010 | M4 Money Supply (MoM)         | UK     | --       |
| 18/02/2010 | Euro-Zone Consumer Confidence | EC     | --       |
| 18/02/2010 | Producer Price Index (MoM)    | US     | --       |

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