# Weekly Traders Update

DOLMEN SECURITIES
member of the ERGO Group

02 May 2006

## Brief Market View

Strong sales of popular blockbuster medicines helped the UK's top two drugmakers beat first-quarter profit forecasts on Thursday, underlining a healthy picture for Europe's pharmaceuticals sector. GlaxoSmithKline, posted a 17 percent increase in EPS on strong demand for asthma and diabetes medicines, as well as vaccines. AstraZeneca profits rose by 38 percent, fuelled by U.S. demand for its Seroquel, Crestor and Nexium drugs.

Shares of Microsoft on Friday dropped by 11 percent, their biggest drop in more than five years, after the company said greater investment to take on rivals would hurt future earnings. Microsoft on Thursday forecast earnings per share of $1.36 to $1.41 for the 2007 fiscal year, starting July 1, compared with consensus expectations of $1.53 per share.

China took global markets by surprise on Thursday by raising interest rates for the first time in 18 months to slow a boom in credit and investment that risks destabilising the world's fastest-growing major economy. The central bank said that it was raising its benchmark one-year lending rate to 5.85 percent from 5.58 percent but would keep its deposit rate unchanged at 2.25 percent.

Futures traders cut back bets the Federal Reserve will raise its interest rate to 5.25 percent by July after Chairman Ben Bernanke said the central bank may pause in its cycle of increases. The yield on July futures contracts fell 8 basis points to 5.08 percent. The drop signals traders now see a 32 percent chance of an increase to 5.25 percent by July, compared with 64 percent earlier in the week. The Fed at some point in the future ``may decide to take no action at one or more meetings in the interest of allowing more time to receive information,'' Bernanke said in remarks to the Joint Economic Committee of the U.S. Congress on Thursday.
Bernanke's comments also prompted futures traders to reduce bets that the European Central Bank and the Bank of England will lift interest rates. The yield on euro three-month interest-rate futures maturing in June slipped to 3.04 percent from 3.06 percent before Bernanke's comments. The yield on U.K. three-month interest-rate futures contracts for December fell to 4.88 percent from 4.91 percent earlier, indicating traders pared bets the Bank of England benchmark will reach 4.75 percent by year-end.

The dollar dipped against the euro last week, falling to a seven month low as a renewed focus on the huge U.S. current account deficit diverted attention from otherwise solid U.S. economic data. Both new orders for durable goods and sales of new homes surged more than expected in March. Following comments made at last week-end's G7 meeting, suggesting that China and other Asian countries let their currencies rise to help fix global imbalances, the focus has shifted to U.S. deficit and a weakening of the dollar as a way of reducing it.

Next week will be busy again on both corporate and economic fronts, though activity could be dampened by public holidays on Monday. On Wednesday we get quarterly results from BSkyB, BMW, and Deutsche Bank, while in Ireland CRH will release an AGM statement. On Thursday there will be quarterly updates from Royal Dutch Shell, Unilever, Total and Elan.
U.S. stock investors will watch this week for signs of tame economic growth that would make a pause in the Fed's current cycle of rate increases all the more likely. Monday's agenda includes the Institute for Supply Management's April manufacturing index, forecast to dip to 55 from 55.2 in the previous month. Wednesday's reports include data on factory orders and the ISM's index on the service sector. Economists expect a 3.5 percent gain in March factory orders, compared with the previous month's gain of 0.2 percent. The ISM's non-manufacturing, or service, index in April is forecast to slip to 59.2 from 60.5 in March. Among the most important reports will be Friday's data on nonfarm payrolls. Economists forecast that U.S. nonfarm payrolls added 200,000 jobs in April, compared with 211,000 in March. The unemployment rate is seen steady at 4.7 percent. Average hourly earnings are expected to increase 0.3 percent, compared with a gain of 0.2 percent in the previous month.
On the data front in Europe, eurozone PMI's are expected to continue trending upwards, underpinning hopes of a pick-up in activity, while eurozone retail sales for March should indicate that consumption remains weak.
The BoE also meets this week. The Bank of England is set to keep interest rates on hold this week for a ninth month in a row amid worries on its Monetary Policy Committee (**MPC**) that soaring energy costs are stoking expectations of higher inflation among households. Its decision will be revealed at noon on Thursday.


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| 3-May | BMW | Q1 |
| 3-May | Deutsche Bank | Q1 |
| 3-May | BG Group | Q1 |
| 3-May | BSkyB | Q3 |
| 3-May | BAT | Q1 |
| 4-May | Royal Dutch Shell | Q1 |
| 4-May | Unilever | Q1 |
| 4-May | ICI | Q1 |
| 4-May | BASF | Q1 |
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## Trading ideas for the week

**BOI (€14.86) Preview of FY results**

- Results preview: Tomorrow 4 weeks, Wednesday 31st May, Bank of Ireland will announce results for the year ended 31/03/06. We are forecasting underlying profit before tax and earnings per share of €1.39 bn and €1.18 respectively, both year on year increases of 15%. A final dividend of c.32.5c per share is expected to be declared going ex on 28th June, providing a yield of 2.2% on the current share price.
- Loan growth: Such strong earnings growth is being driven by very strong loan growth at both the group's Irish and UK mortgage and business lending operations, as well as buoyant life and pension trading conditions. Together with IL&P, BOI is the joint number one player in the Irish life and pensions market, and the buoyant trading conditions in this market should also help stabilise BIAM's profitability in 2006.
- Cost savings: BOI's cost reduction programme remains on course to achieve savings in excess of the €30m originally targeted for the current financial year. With the bank targeting a total reduction in group staff numbers of 2,100 by 2009, this annual cost saving should grow to €120m by then, providing a very useful offset to the lower margins and increased competition of the Irish bank sector.
- Life buoyant: Our view is that BOI's greater than average exposure to the buoyant Irish and UK mortgage and life & pension markets, when combined with its current cost saving programme should help drive further group earnings growth of 13% per annum over the next 2 years. This would generate a current year eps of €1.33 for the 12 months ending 31/03/07, growing to an eps of €1.50 for the 12 months ending 31/03/08.
- Problem businesses: This is because the profitability deterioration at BIAM and the start-up costs of the UK post office joint venture will be much less of a drag on group earnings than they have been over the past 12 months. BOI is also well placed to profit from the recovery in UK mortgage lending which is starting to take hold currently.
- Further upside: Therefore, we recently upgraded our 12 month price target to €16.50 (11% further upside), which is based on the current European bank sector average of 11x eps of €1.50 for the 12 months ending 31/03/08. When combined with the group's dividend yield of c.3.4%, this generates an attractive 12 month return for quite a low risk earnings profile: BUY.

**GSK (1,554p) Q1 results beat forecasts**

- Q1 Results: Last week GlaxoSmithKline reported better than expected results for the three months ended March 31st 2006, driven by strong sales of its key drugs and vaccines. Turnover and EPS of £5,813m and 26.5p were year on year increases (on a constant exchange rate basis) of 10% and 17% respectively, and were ahead of consensus forecasts of £5,625m and 23p.
- Pipeline progression: GSK also reported 'significant progress' in its near-term drug development pipeline, with its cervical cancer vaccine Cervarix filed with EU regulators and 13 other markets in March and strong Phase III data on Tykerb, a new oral medicine for breast cancer. This should support an earlier than expected filing with European and US regulators in the second half of this year. GSK is expected to present important Phase III data for Tykerb at a high-profile cancer conference in the first week of June and we believe that this will be the next major catalyst for GSK's share price.
- FY guidance: The company reiterated its current guidance that it expects to achieve earnings growth of around 10 percent in 2006, but following these results it is more than likely that this figure will be revised upwards in the coming quarter. The company also reaffirmed its commitment to the progression of its current share buyback programme and expects to repurchase up to £1bn worth of shares in 2006. In Q1 it bought back £219m worth of shares.
- Product launches: GSK possesses one of the most exciting R&D outlooks in the sector. The next 12 months will see a host of key updates hitting the market, including 8 new products expected to enter Phase III development, 7 regulatory filings and 7 important product launches.
- Further upside: Given that the sector is currently trading at 19x 07 EPS we believe that no more than a 10% discount for GSK is appropriate to reflect its slightly slower than average earnings growth and therefore, our 12-month price target price of 1,650p is based on 17x 07 EPS of 97p. BUY

**Aviva (£8.17) Strong Q1 sales**

- Q1 sales: Last week Aviva announced very strong life and pension sales of £6.8 bn for the 3 months ended 31/03/06. This was 12% better than the consensus forecast of £6.08 bn, and was a year on year increase of 20%. The result was 9% better than even the top end of the forecast range of £6.24 bn.
- Prudential offer: Our current view is that the end result of the recent £7.08 per share takeover offer for Prudential is that Aviva itself may end up receiving a takeover approach. This is because the offer confirms Aviva's ambitions of building a global and US presence, and its European exposure may be of interest to AIG or AXA.
- In play: Several examples from the bank sector within the past 10 years show that when a UK financial demonstrates that is open to doing a transformational deal, it ultimately ends receiving a takeover approach itself.
- History repeats: The end result of Abbey National's bid approach to Bank of Scotland, which was similarly initially publicly rebuffed, was that Lloyds TSB then made a takeover bid for Abbey National, which was only prevented from happening by concerns of the UK Trade & Industry Secretary over market share in current accounts.
- Stand-alone value: However, even on a stand-alone basis, Aviva's share price would appear to have further upside potential from current levels as a result of the continued buoyancy of the UK life sector. Given that Aviva's 2006 return on embedded value of 16.8% is 21% stronger than the UK sector average of 13.9%, our view is that its price to embedded value (EV) should trade at a similar premium to the UK sector.
- Further upside: Therefore, our current 12 month price target for Aviva of £9.50 (17% further upside), is based on 1.8x 2006 EV per share of £5.30: BUY.


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