# Weekly Traders Update

DOLMEN SECURITIES

member of the ERGO Group

## 03 April 2006

**Brief Market View**

The US Federal Reserve moved US interest rates to 4.75% as expected last week however the tone from the Fed was a little more hawkish than had been anticipated. The market had been hoping that 5% would be the peak in US rates this year but it is not looking likely following the commentary from the FOMC that commodity price may lift inflation expectations near term. Bonds sold off and yields spiked in the US with US 10 year yields rising to 4.85%, the highest level since May 2004. Despite this unwelcome news on interest iates equities performed well into Fridays close. The focus shifts this week to Europe with the ECB and Bank of England due to decide on rates this week. We are not expecting any change in European (2.50%) or UK (4.50%) rates but commentary from Mr Trichet in his post meeting speech will be closely monitored and in particular are reference to the inflation outlook in Europe. In the US on Friday we get the important employment data in the form of March Non Farm Payrolls which are expected to show a rise of 198k. M&A activity and strong corporate earnings continue to provide support to the market on any particularly weak days. Asian markets rallied on strong demand for Technology stocks and companies with significant exposure to global markets rallied as the Yen weakened against the Euro making their products more price competitive abroad. Corporate newsflow is relatively quiet this week with BP reporting a trading on Wednesday being the highlight of the week.

**Glaxosmithkline - 1510p - Near term catalysts ahead. BUY**

**Cancer data:** GSK is expected to present important data 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. The company will announce data for its key cancer drug, Tykerb. The drug is estimated to have potential for over $3bn in sales, and in anticipation of good news we can see shares enjoying a decent run in the weeks leading up to this conference. In the nearer term, the next major news due from GSK will be the announcement of their Q1 results on 27 April. **Upgraded guidance:** In February GSK reported results for year ended 31st December 2005. The company reported revenues of £21,660m and EPS of 82.6p, representing year on year increases of 8% and 21% respectively, and beating consensus forecasts of £21,196m and 81p. The company also increased its guidance for 2006 EPS growth. Consensus forecasts had indicated high single digit earnings growth for 2006, but the company now expects this figure to be around 10%. **Cervarix update:** The company also confirmed that Cervarix will be filed in the US before the end of 06. This confirmation is a positive for the company as there had been some speculation of a potential delay until 2007. While in Europe the company expects to hear back from European regulators within 12 months on its submission for Cervarix approval. **R&D upside:** The company also reiterated its exciting R&D outlook for 2006. 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. These updates will keep sales forecasts ticking upwards over the course of 2006. Over the next 4-5 years, c.83% of the company's pharmaceutical revenues are likely to remain immune from competitive threat. **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 price target target price of 1,650p is based on 17x 07 EPS of 97p. The strength of GSK's pipeline remains the key driver of our investment case, and we expect to receive further evidence of its positive impact on earnings over the coming months, and therefore we reiterate our BUY recommendation on the stock.

**Bank of Ireland - €15.35 - Upbeat trading statement, upgrading price target to €16.50**

**Mortgage lending:** Last week, Bank of Ireland released a very upbeat pre-close period trading statement for the year ending 31/03/06. Overall, the trading statement indicated that very strong loan growth is continuing at both the group's Irish and UK mortgage and business lending operations. Life sales: The trading statement also confirmed that the strong life and pension sales growth of Q4 2005 has continued into 2006, which should also help drive a recovery in 2006 at BIAM. Together with IL&P, BOI is the joint number one player in the Irish life and pensions market. **Cost savings:** Similar to IL&P, the particular strength of these 2 business areas emphasized in this trading statement should facilitate upgrades of c.2% to consensus earnings forecasts, with the group now guiding 15% growth in underlying eps for the year ending 31/03/06. This would give an eps of €1.18. As we had anticipated, 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. **Strong growth:** 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 and a year on year recovery in fund management fees, should help drive further strong group eps growth to c.13% to €1.33 for the 12 months ending 31/03/07. **Attractive yield:** Therefore, we now upgrade our 12 month price target to €16.50 (7% further upside), which is based on the current European bank sector average of 11x earnings per share of €1.50 for the 12 months ending 31/03/08. When combined with the group's dividend yield of c.3.6%, this generates a sufficient further total return to justify maintaining our current BUY recommendation.

**BHP Biliton 1097p– Further positive comments out of China, time to take profits.**

Mining sector strong this morning (+3%) and oil trading at $67.13 overnight. BHP most diversified of the miners with circa 25% of group revenues in Oil. Comments from Australia and China to Sign an agreement to ensure Uranium exported to China is used only for Civilian purposes. Also comments from the Chinese Premier that iron ore prices should be set by the market reversing his governments previous markets. BHP is one of the most volatile names in the FTSE100 and has rallied by 21% over the past 4 weeks. We are recommending clients to take profits this morning and would use any weakness towards 1000p as another short term buying opportunity.

**BP 668p Results due on Wednesday BUY**

BP is our top pick in the UK Oil sector. BP effected buybacks and dividends of $19bn in 2005, making a total of $40bn over the last three years. The company is committed to a distribution of up to $50bn between 2006 and 2008 assuming Brent oil price averages $41 a barrel. With an oil price of $60 a barrel, this could rise to around $65bn.

**HBOS 961p Weakness following results in March represents good buying opportunity.**

We upgraded HBOS following the strong results in Mid-March. A lack of material earnings upgrades from Brokers was the main reason for the sell off in the share price. HBOS remains our top pick in the UK financials and trades on a undemanding 8.7x next years earnings and pays a dividend yield of 3.75%.

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**05April**
BP (Trading Statement)

11 April
Adidas (Investor day)
Mark & Spenser (Trading)

12April
IFG (FY)
GUS (Trading)

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US March Non Farm Payrolls
(198k)

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**Adidas (163) Strong fundamentals remain intact and bullish comments from CEO in German weekend press**
Group CEO, Herbert Hainer, told a German newspaper (Taggesspiegel) that the firms Q1 figures will reflect the strong demand for soccer jerseys and footballs ahead of the World Cup tournament this summer. He confirmed that it expects to surpass all its sales targets for the 2006 World Cup. **Buying opportunity:** Since the end of January shares in Adidas have fallen from their all-time high of 176, mainly due to concerns over its acquisition of Reebok. Fears over changes in personnel and patent infringements have also contributed to the recent weakness. However with the strategic rationale for the Reebok deal remaining intact and the imminent sales boost from the World Cup in June we maintain our BUY recommendation on the stock. **Recent results:** In early March Adidas reported fourth-quarter results largely in line with expectations, but it was news of a weak order backlog at Reebok and higher costs associated with its acquisition that grabbed the headlines. Adidas said its net profit was hit by costs relating to the recent takeover of Reebok. The company reported a net loss of €4m compared with a profit of €20m in the fourth quarter last year. While orders were down at Reebok, we are confident that management can turn this around and generate a positive sales growth in the third quarter of 2006.
**Earnings accretive:** The complementary nature of the two businesses in various geographical regions, products and customer segments provides a significant opportunity for increased value creation. The deal will give rise to substantial cost savings (in the region of €125m) as well as incremental revenue and profits from more complete coverage of all consumer segments. Taking over Reebok will more than double the German group's North American sales. The deal will create a company with combined worldwide sales of 8.9 bn, closing the gap with Nike, which has annual sales of c.10 bn. The deal will boost earnings by at least 10% in the first full year, rising to c.20% over 3 years. **Investor day:** Adidas will hold an Investor Day in London on April 11 and we believe that this will be the catalyst for an improved performance of the company's share price. Management from Adidas and Reebok are expected to provide the market with further details of the integration process and an overall view of the company's strategic outlook. **Share split:** Adidas also announced that it is proposing to split its shares on a four-for-one basis. Adidas shareholders will be asked to vote on the proposal at the AGM, which will take place on May 11. The move would improve liquidity in the stock and make the shares more attractive to private investors. **Peer discount:** Based on 07 earnings estimates Adidas is trading at a c.16% discount to its peers, Nike and Puma, but given Adidas' stronger earnings growth, our view is that this valuation gap should close over the course of 2006.

**Lloyds TSB 567.5p Strong Fundamentals and rumoured M&A activity**
Lloyds TSB recently announced results for the year ended 31/12/05. Profit before tax of £3.47 bn and eps of 44.6p were ahead of consensus forecasts of £3.315 bn and 42p, and were year on year increases of 4% and 8% respectively. The results showed modest retail banking growth and good cost control being less offset by higher bad debts than had been expected. The results also indicated that there has been no further deterioration in retail unsecured credit quality since the bank's trading statement in December, and that the outlook for Scottish Widows is continuing to improve. This business and Lloyds' Insurance and Investments division in general is benefiting from a strengthening UK life and pensions market, as well as increasing bancassurance volumes. Wholesale quality: It is also worth noting that even though the 2005 bad debts charge as % of average loans was higher in retail banking, it was lower at the group's corporate lending operations as credit quality at the bank's Wholesale & International business remained strong. Takeover potential: In January 2005, we downgraded our Lloyds TSB recommendation from BUY to NEUTRAL, as our view was that the takeover speculation at the time represented an opportunity for some profit-taking. However, this year, with the bank's management significantly less "new to the job", having joined after June 2003, we see greater potential for an approach being made.

**William Hill 605P - Good performer last week driven by UK Broker Upgrades.**
The stock has recovered well from 555p two weeks ago. Results at the Cheltenham festival were favourably for the bookies in general. The fundamental story of William Hill remains on track which focuses on an undemanding valuation, good dividend yield, Stanley Leisure integration going well and a share buyback programme of circa £300m this year. A UK broker upgrade last week pushed the stock above 600p for the first time since early January.

**BMW AG €45.40 FY2006 Earnings expectations increased by management.**
Despite doing well in absolute terms over the past year and since the beginning of 2006 BMW has been an underperformer versus the European Auto sector and the German market. FX headwinds from their US exposure and significant increases in raw material costs have kept BMW earnings flat over the past three years. A substantial product revamp in the form of the new 3-series (44% of total group sales) and 5-series also kept Capex at historically high levels. But things are changing and are likely to keep moving in BMW's favour. Last week the group confirmed it expects car sales to hit a record level in 2006 driven but a significant ramp up in 3-series sales and strong sales of the new 5-series. Full year 2006 PBT is expected to be EUR4bln, well ahead of consensus of EUR3.7bln. From a product perspective BMW is hitting the "sweet point" in its product cycle and it is likely to continue well into 2007. BMW has an exceptionally strong balance sheet sitting on circa €4.9bln net Industrial cashflow position an additional 3% share buy back looks likely over the next 6-9 months. At less than 10x next years earnings the BMW valuation case remains compelling. Further broker upgrades are likely and monthly unit sales indicators (Jan +15%, Feb +14%) should continue to point to aggressive sales numbers.

**Vodafone 121p Compelling valuation, good dividend yield and special dividend from Vodafone Japan. BUY**
Vodafone suffered last week following the announcement from the European Union that it plans to bring down roaming charges within the Eurozone. It is likely that the mobile operators will contest this ruling and it will be some time before any roaming fee reduction actually takes place. Vodafone recently confirmed the sale of its Vodafone Japan operations to Softbank for £8.9bln. The sale is expected to result in a special dividend of £6bln to shareholders and exact details of this are expected to be confirmed at the group AGM on 30th May. This move by Vodafone management sends a clear message to the market whereby the group are strongly focused on the groups core assets in Europe and emerging markets. Further such disposals should not be ruled out and in the interim the compelling valuation case, proposed special dividend and attractive dividend yield should provide a good support for the share price from current levels.


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