

# Weekly Traders Update



## Brief Market View:

A reasonable performance from equity markets last week despite weak economic data, another surge in the oil price and the aftermath of hurricane Katrina. The UK market performed well last week buoyed by renewed M&A activity. Exel, the UK logistics company, confirmed they had received a preliminary approach from Deutsche Post while Scottish Power rallied on further speculation that E.ON AG may be considering a bid for the FTSE100 constituent. The US dollar came under selling pressure last week as economic data disappointed on a number of occasions. A weaker than expected ISM (Manufacturing) survey and a disappointing Chicago PMI put the dollar under pressure and pushed Euro/USD above 1.25 for the first time since May.

US markets are closed today for Labour day but focus will shift later in the week to the release of the non manufacturing ISM reading, the Fed's Beige Book and speeches from Fed officials on Tuesday and Wednesday. The main event in the UK will be the interest rate decision on Thursday, where UK rates are expected to be left unchanged at 4.50% following last month's cut of 0.25%. From a results perspective, Kingspan reported strong numbers this morning and the stock is trading at €11.05 +1.38%. We are recommending a switch into Grafton Group. William Hill also reported interim results inline with expectations this morning. Partygaming reports H1 numbers on Tuesday. Ryanair traffic numbers are due later on this morning and Irish Life & Permanent report H1 earnings on Wednesday. Irish Continental Group report interim results on Friday morning. **Market outlook** - The news last week that the US administration will release oil/petroleum from its strategic reserves pulled the oil price lower. Trading at \$66.90 this morning it is down some \$4 dollars from last week's highs as speculators don't want to risk being caught long oil as the US administration reacts to the devastation in New Orleans. Short term interest rate expectations have also been reduced over the past week and the relative valuation of equities versus bonds is now looking very attractive, particularly when you look at the European market. Two speeches this week from Fed Governors Moskow and Yellen. Any indication that the Fed may be closer to the near term peak in US rates would be welcome news for equity markets but could prompt a further slide in the Dollar. We are expecting a near term bounce in equity markets as the oil price retreats and investors re-assess the impact of lower interest rate expectations near term. Euro/USD may trade towards 1.27/1.28 near term and Euro GBP should remain weak at 0.67-0.68.

## Bank of Ireland - Buy €13.00

The shares in Ireland's second largest retail bank have fallen almost 6% since the beginning of August as the market reacted to the disappointing results from RBS. With 24% of its profits coming from the UK through its Bristol and West subsidiary, the reaction within the market was understandable to a certain extent. Bank of Ireland however is more than just a one-trick pony, and the bulk of its profits (73%) are still generated in the Irish buoyant market. This buoyancy was confirmed with the upgraded guidance issued by AIB in its recent results release. Crucially for Bank of Ireland, it has reached agreement with the IBOA over the terms of the redundancy proposal which will see 2,100 job reductions between now and 2009, clearly a positive for the bank's cost base. Equally, the flow of mandates away from its asset management division BIAM, appears to have been arrested, another positive. While the UK market still poses challenges for the bank, particularly with its tie-up with the UK Post Office, the recent price fall appears overdone. Based on F/Y 2006 EPS of €1.33, the shares trade on a multiple of 9.9x and yield 4.2%. This compares to AIB on 11.3x '06 earnings and HBOS on 9.7x '06 earnings.

## GlaxoSmithKline - Buy 1340p

Pharmaceutical giant GlaxoSmithKline recently reported earnings ahead of consensus forecasts yet the shares failed to respond in any meaningful way. Despite reporting Turnover of £5.246bn (+6%), Operating Profit of £1.711bn (+13%), Profit Before Tax of £1.662bn (+9%) and EPS of 20.4p (10%) the shares remained unchanged at current levels. This was somewhat surprising given the fact that the reporting period included the March production setbacks at its Puerto Rican production facility involving two key drugs Paxil and Avandamet. The main reason for the market's lukewarm reaction to GSK's results was the release on the same day of better than forecast figures from peer company AstraZeneca. While AstraZeneca's results were extremely impressive, so too were the GSK numbers. More impressive however is the pipeline of drugs currently being developed by Glaxo compared to Astra, and also the fact that the generic risk to Glaxo is somewhat less. The underperformance of the Glaxo share price relative to AstraZeneca (up 11.6% since its results) is unwarranted and provides a good buying opportunity in a defensive stock that also promises growth potential. The shares trade on 15.8x 2006 EPS compared to a sector average of 16.5x and AstraZeneca on 16.1x. **BUY.**

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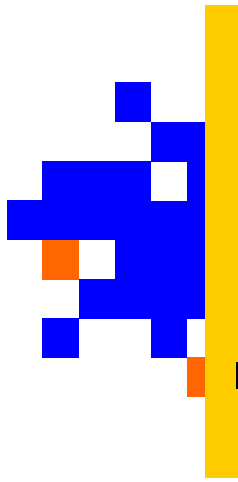
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## Hilton Group 312.5p

The group has rebounded well following the spate of terrorist attacks in the UK even while news flow remains relatively quiet. While obviously of concern to Hilton Group, the over emphasis on the hotel side of the business is somewhat misplaced as this business accounts for just 15% of group turnover. Operating profits in the hotel division for 2004 were £197m, however slightly less than half (48%) of this is generated in the UK. At the time of the company's trading update in May the larger contributor to group profits, Ladbrokes, was trading in line with the company's expectations with stronger turnover being slightly offset by lower margins. The contribution from betting terminals grew strongly with 7,522 Fixed Odds Betting Terminals and Amusement with Prizes now deployed in the UK. The company is continuing with its £300m to £400m hotel asset disposal programme, while as of May, Net Debt stood at £748m down from £1,035m a year previously. Revenue split by region: UK 87%, Europe 11%, Rest of the world 2%. Profits by division: Betting 73%, Hotels 27%. Betting Profits by division: UK Retail 79%, Ireland & Belgium 5%, Telephone 6.5%, eGaming 8%. The shares trade on 13.9x Dec '05 EPS and 12.3x Dec '06 EPS and yield 3.5%. While short term uncertainties may impact the shares, longer term the shares are excellent value. **BUY.**

## Kingspan H1 beats forecasts

Summary: Kingspan posted a 55 percent rise in half-year pre-tax profit today, ahead of forecasts, on the back of strong demand. Kingspan said pretax operating profit for the six months to the end of June rose to €62.4 million from €40.4 million a year earlier and compared with forecasts ranging between 53.9 million and 61.4 million. EPS climbed 56 percent to 30.7 cents from 19.7 cents last time, compared with forecasts of 26-29.7 cents. Comments from management/Outlook: "The continued move towards energy efficient construction and environmental solutions remains the main contributory factor in Kingspan's growth. "Against the background of a robust Irish market, an evolving U.K. construction market, and improving Central European and U.S. markets, the Group anticipates a satisfactory outcome for the year as a whole." Kingspan sees full-year revenue at 1.25 billion euros in 2005 and raised its estimates for operating profit to 143-144 million euros after strong first half figures today. Further upgrades to FY forecasts likely. Revenue €580m +32%, PBT €62,4m +55% EPS basic 30.7c +56%. **Take profits and switch into Grafton Group ahead of results on 13<sup>th</sup> September.**

## British Land 910p

British Land is a property investment company based in London with a portfolio focused on out-of-town retail sites (41%) and Central London offices (40%). Income is secured via long leases and a good quality tenant base, while income growth will come from reviews and new lettings, a significant proportion of which is either contracted or indexed. The company also operates 12 joint ventures which also helps extend the company's exposure, but also reduces the funding pressures. The company currently trades at a 25% discount to the estimated 2006 NAV of 1125p, compared to a discount of just 14% for its peers. The outlook for the company's portfolio is good with an improving yield trend in the London Office market, and retail rentals, although likely to be slow, will nonetheless continue to perform well over the next few years. The quality nature of the groups portfolio and the leasing arrangements in place, leave the group well protected against the current UK interest rate uncertainty. **BUY**

## CRH €22.80

Results last week were in line with expectations. Strong performance from US assets, Europe not a bright spot yet but macro indicators are starting to turn across Europe and CRH is well exposed in that region. EUR190m acquisitions since the last update, EUR100m of that the French acquisition. H2 typically the most active for CRH from an M&A perspective and we expect that trend to continue.. EUR25 target, looks like one of the best value stocks in the Irish market currently.

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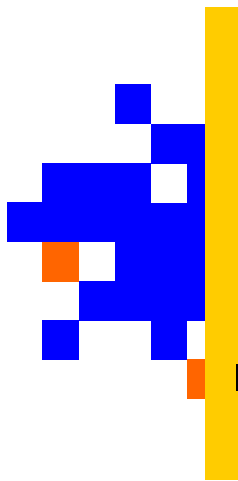
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## Diageo – Positive results announced 823p

Diageo has posted an expected fall in annual profits, but revealed plans to double its share buyback programme and said it was set for a pickup in growth this year. The company expects growth to be boosted by bigger price rises, cost cutting and a steadying of the ready-to-drink market for products like Smirnoff Ice. **Share Buy-Back:** Finance Director Nick Rose said the group would raise its share buyback programme in the current 2005/2006 year to double the 710 million pounds of shares it bought back in 2004/2005 and would keep it at the higher level for the following year. Rose said there were few acquisition opportunities for Diageo in spirits because of its size, while beer and wine purchases were mainly highly priced, and so it made sense to return some of Diageo's strong cash flow to shareholders.

**Management Comments/Outlook:** "We achieved 7 percent growth last year with some tough headwinds blowing against us, and would expect to do at least 7 percent this year" Expecting price rises to be higher than previously, especially in the strongly-growing U.S. spirits market. The ready-to-drink market is showing signs of stability after previous sales declines. Diageo still faces tough markets across most of Europe in spirits and in Britain, Ireland and Nigeria in beer, but Rose said the group had the brands and marketing spend to counter these problems during the current year. The group added it expected volume growth of 3 percent and sales growth of 4 percent in the current 2005/2006 year, similar to that seen in the 2004/2005 year just being reported. **Results:** Turnover £9.4bn +5.6%, PBT 2.003bn – 3%, EPS 49.1p +1.9%. **Sales by Region;** Europe 43%, US 30%, Asia 11%, Africa 8%, Latin America 8%. **Sales by Brand;** Smirnoff 32.8%, Johnnie Walker 17.2%, Guinness 14.3%, Baileys 10.9%, J&B 8.5%, Captain Morgan 8.5%, Others 7.8%. **NEUTRAL**

## FBD €32.80

Results: Well ahead of forecasts. Operating profit up 30% to €86.8m vs €72m (e). EPS up 36% to €1.92 vs €1.62 (e). Likely to see some upgrades to estimates in the coming days. Comments from Management/Outlook: Chief executive Philip Fitzsimons said the group's success in pursuing its development plans is reflected in the half year results, with new business volumes offsetting the impact of rate reductions on premium income. The results also benefited from a particularly favourable claims outcome, he said. Whilst the latter is unlikely to be repeated and rate reductions will have greater significance for earned premium income in the second half year, Fitzsimons said he is confident of achieving satisfactory full year results. **Neutral**

## Glanbia €2.60

Results: Fall in first-half profit & decline in operating margin. Operating profit of €38m in the six months to the end of June compared with 41 million in the same period last year. Earnings per share slipped to 9.01c from 9.03c previously, while turnover rose to €926m from 880.4m. The company's operating margin declined by 60 basis points to 4.1 percent due largely to competitive pressures in its Irish agri-business and chilled foods divisions. The group's operations were also negatively impacted by higher energy costs. Outlook: Given a difficult trading environment it expected full year earnings to be broadly in line with 2004. "The out-turn for last year would have been around 20.6 cents (earnings per share). We believe that's where we'll be," said Group Managing Director John Moloney The consensus market forecast would have been 3-4 percent ahead of that. Summary: Revenue €880m +5% YoY, PTP €38m -7% YoY, EPS 9.03c -0.2% YoY. Sales by division; Food Ingredients 58%, Consumer Foods 29%, Agribusiness 12%. Sales by region; USA 44%, Ireland 40%, RoE 16%. **Would not be buyers of the stock, weak sector fundamentals.**

## Paddy Power – Expensive valuation and earnings disappoint. €14.40

Retail business was particularly disappointing, operating profit came in at €6.6m vs €12.2m last year. Highlight was the performance of its online division, operating profit of €8.2m was up from 3.7m last year and was ahead of estimates of €7.2m. Outlook statement from mgt relatively disappointing re: gross win margins, though upbeat about the online division's prospects. Profits by division; Retail 61.44%, Telephone 19.10%, Online 19.46%. Stock is still expensive even after the pullback post results. Revenues by region; Ireland 72%, UK 28%. **Switch into William Hill or Hilton Group** for any clients that wish to maintain exposure in the sector.

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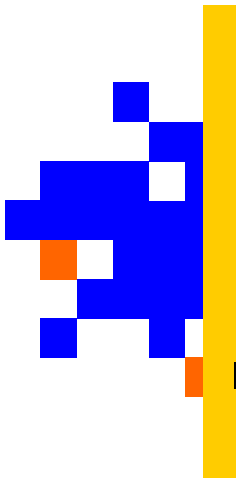
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## Kingfisher 246p

Interim results are on September 15<sup>th</sup> and are likely to show substantial year on year decreases, with EPS down by about 20% as the company, particularly its B&Q division, struggles amid a difficult macro economic environment. But like Boots, it is M&A activity that will keep markets interested in Kingfisher. News that Warren Buffett has started building up a stake in Kingfisher and Home Depot has fuelled speculation that Kingfisher may be primed for some form of M&A activity. Kingfisher would be vulnerable at the moment to such activity, after changing the management at its core British business and a profit warning last April following a slide in sales. Despite its struggling UK operations, it would be its presence in China that would attract Home Depot. Weak retail sales in the UK, increased competition in France and a profit warning from UK building company Travis Perkins have been the key factors tormenting the stock but we feel the stock represents reasonable value at 245p. Warren Buffet is well known for his ability to spot beaten up companies that are ripe for a picking. KGF profits by division: B&Q 53%, Castorama 20%, Brico Depot 14%, other 12%. **BUY**

## Boots 617.5p

Boots is scheduled to provide investors with a pre-close trading update at the end of September, but it will be the sale of its BHI (Boots Healthcare International) division that will attract most interest. GlaxoSmithKline and Reckitt Benckiser are among six bidders shortlisted to buy the £1.2bn healthcare business of Boots. Richard Baker, the chief executive of Boots, put BHI up for sale in April with a price tag of £1.2bn following a series of disappointing trading updates. Interest for the business has been strong, and that the eventual winner of the auction may have to pay more than £1.8bn. The market will continue to speculate on the eventual sale price, and this speculation is likely to act as a positive catalyst for Boots' share price in the short-term. Again the market backdrop and business outlook remain challenging but private equity interest will remain a key driver of stock price performance near term. At 617p the stock is at the top of its recent trading range and we would **wait to buy on any weakness towards 605p - 610p**.

## Scottish Power 545p

Low risk utility company, very strong performer YTD, had been range trading since June 2005 (485p - 515p). Strong performance in the past week has pushed the stock to 545p. Talk in Germany is that Germany utility **E.ON** is considering a bid for UK utility **Scottish Power**. News over the weekend that E.ON has appointed Lazard to possibly look at taking over the UK FTSE100 constituent. The rationale behind such speculation is based on the following: Scottish Power recently sold its under-performing US unit PacificCorp for \$5.1bn. While this is positive, it is really only beneficial to the company if it uses the proceeds to acquire something else. E.ON recently disposed of its Viterra property arm for €2.4bn. The company already has net cash of circa EUR6.5bn, so with almost EUR9bn of free cash pressure will mount for the company to use it. Scottish Power has a Market Cap of £8.5bn or €12.5bn, so not out of range for E.ON. At its current price of 465p Scottish Power trade on 11.6x Mar '06 EPS, and 11x Mar '07 EPS, compared to a Sector average of 13.8x. E.ON already has 8.6m customers in the UK gas and electricity market through the acquisition of PowerGen in April 2001. The alternatives for Scottish Power are limited, with a merger with Scottish and Southern Energy one option or a distribution of the cash by way of a special dividend. **We remain buyers of the stock at current levels and expect the stock to reach 600p into year end. BUY**

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