

Weekly Traders Update



8 May 2006

Brief Market View

Airlines dominated the headlines last week with BA, Ryanair and EasyJet all releasing encouraging updates, while Air Berlin announced that it was postponing its proposed IPO for a week. British Airways and Ryanair reported a jump in April passenger traffic on Thursday, driven by the timing of the busy Easter holiday break. BA said passenger traffic rose 9.8 percent for the month, while Ryanair said its passenger numbers rose 29 percent to 3.4 million in the month and its load factor rose to 85 percent from 81 percent. BA's load factor rose 4 points versus a year ago to 78.7 percent in April. easyJet said on Wednesday its prospects were improving, helped by cost cuts and ancillary revenues. EasyJet said it now expects pretax profit growth of between 10 and 15 percent for the year compared with a previous outlook for mid to high single digit percentage profit growth.

Miners were again a major support to the FTSE 100 as copper prices soared more than 8 percent to a record high, supported by positive comments from BHP Billiton. BHP said industrial metals, either at or close to record peaks, would stay buoyant until inventories increase from current low levels. Brent crude futures reached a new record high of \$74.97 on Tuesday on persistent fears about supply disruptions, especially from Iran, and aggressive fund buying across the commodities sector.

Non-farm payrolls data on Friday was the number that markets kept a close eye on all week. US employers added 138,000 jobs in April, far fewer than had been anticipated, while annual wages rose at the strongest rate in more than 4-1/2 years, a US Labour Department report on Friday showed. Wall Street analysts had expected 200,000 new jobs would be created last month. Not only was the actual figure below forecast but the government also said 36,000 fewer jobs were created in the February-March period than previously thought. It revised March job growth down to 200,000 from 211,000 originally estimated and February down to 200,000 from 225,000. The unemployment rate was unchanged from March at 4.7 percent. Bond prices rallied on the data, heartened that slower job growth might limit further interest rate increase by the Federal Reserve. The dollar dropped to one-year lows against the euro immediately after the jobs data was published. The euro shot up to \$1.2765 from around \$1.2685 before the data.

The dollar hovered at one-year lows against the Euro for much of week after the ECB indicated that a rate hike was likely in June. The ECB announced that is to leave interest rates unchanged at 2.5 percent, but Trichet said high oil prices and advancing economic growth would cause the ECB to remain "vigilant" about protecting against inflation. The Bank of England kept its benchmark interest rate unchanged at 4.5 percent on Thursday.

The dollar had strengthened earlier in week in the wake of comments made by Ben Bernanke in an interview with CNBC. The Fed Chairman said that the Fed was still aggressive on inflation and he was concerned that people would see him as dovish. The dollar jumped immediately higher after Bernanke's comments that the market "got it wrong," when it took his recent testimony before the JEC as an indication that the Fed was giving dovish signals on interest rates.

There is no let up in the recent deluge of corporate and economic newsflow over the coming week. In Ireland the key events to look out for are **Grafton** (AGM on Monday), **C&C** (FY on Tuesday), **Fyffes** (EGM on Tuesday and ex div on Wednesday), **Anglo Irish Bank** (H1 on Wednesday), **McInerney** (AGM on Wednesday) and **United Drug** (H1 on Thursday). In Europe we get Q1 numbers from **Adidas** and **Deutsche Telekom** on Tuesday and Thursday respectively. In the UK **Aviva** and **Lloyds** hold their AGMs on Wednesday and Thursday respectively.

The Fed's policy-setting Federal Open Market Committee meets on Wednesday and is expected to nudge interest rates up another quarter percentage point after its deliberations that will include a discussion of wage and price rises.

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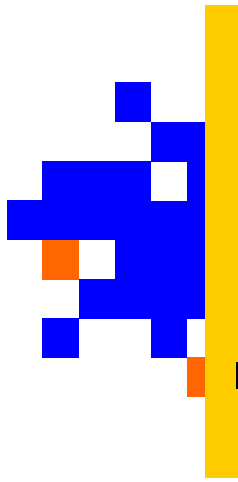
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Trading ideas for the week

Sterling Energy (31p) Management meeting update

- Management meeting : Our recent meeting with Sterling Energy management of CEO Harry Wilson and Finance Director Graeme Thomson, focused on the major amount of new production currently coming on stream from the company's Chinguetti oil field offshore Mauritania. Production levels to the end of March averaged 59,000 bpd and should peak at 75,000 bpd in H2 2006.
- Production increase : This keeps Sterling's oil production on course to average 4,200 barrels of oil per day in 2006 and 5,600 barrels of oil per day in 2007. When combined with the company's expected average gas production of 10.96 million cubic feet of gas per day in 2006 and 13.7 million cubic feet of gas per day in 2007, this would generate cash flow per share of 3.1p in 2006 and 5p in 2007.
- Earnings growth : These earnings estimates are based on an average gas price of \$7 per thousand cubic feet of gas in 2006, and an average gas price of \$6 per thousand cubic feet of gas in 2007, as well as an average oil price of \$50 per barrel in both years. Even though the average gas price achieved in 2005 was \$6.37 per thousand cubic feet, with the gas price pushing above \$10 last winter, the company was able to hedge forward a significant portion of this year's gas production at \$8.90.
- Further upside : Given that peers with production such as Burren Energy and Tullow Oil trade at an average of 7.9x 2007 cash flow per share, and that the majors such as BP and Shell trade at an average of 7.3x 2007 cash flow per share, it is reasonable that Sterling should be valued at 7x 2007 cash flow per share of 5p. Therefore, we now upgrade our 12 month price target from 30p to 35p (13% further upside), which is based on 7x 2007 cash flow per share of 5p.
- Recent results : Sterling recently announced strong results for the year ended 31/12/05. Turnover, EBITDA and profit before tax of £13.6m, £8.8m and £6.1m respectively were ahead of consensus forecasts of £12.9m, £6.5m and £4.4m, and were year on year increases of 18%, 13% and 45%. Sterling also announced an exploration well programme in Africa for at least 5 wells to mid-2007, in which the company is largely carried, with an expansion of this drilling programme to enhance reserve and production upside anticipated. A 4,000 km 2-D seismic programme offshore Madagascar has been brought forward and is now underway. Sterling Energy's share price has risen by 80% since our BUY note of 01/12/05 : **BUY**.

Carphone Warehouse (342p) High growth potential

- Company profile: The business of The Carphone Warehouse Group is split into two separate areas of activity: Distribution and Telecoms Services. Its distribution business involves the operation of retail outlets and the provision of a variety of insurance products for its customers. The Telecoms Services division comprises two businesses, Mobile and Fixed.
- Q4 update: In early April CPW updated investors on its fourth quarter trading. The company said it expects to report pretax profit and EPS in line with market expectations for the year to March 31, 2006. The company is expected to report pretax profit of £135m and EPS of 10p in fiscal 2006. It said it had 1,778 stores at the year end and 3.1 million mobile customers. It expects to open a further 250 stores and increase connections by 15% from 2.23 million by March 2007.
- Broadband rollout: In the same release CPW unveiled an aggressive plan to offer free broadband Internet to consumers who subscribe to its fixed-line voice packages called 'Broadband Free Forever'. Carphone said it will charge £21 a month for fixed-line voice calls and free broadband Internet, significantly cheaper than packages being offered by existing operators. CPW also announced plans to accelerate the unbundling process to achieve "full local loop unbundling" at 1,000 BT exchanges by May 2007, which would allow it to reach almost 70 per cent of the population in the UK. The company's earnings for 2006-07 will take a hit of £50m from broadband related development costs, but the company has said that it expects its broadband division to contribute a profit of £30m in 2007-08.
- Outlook: The company said that it expects to have 3.5 million (which appears to be slightly conservative) residential voice customers by 2009, with over half of those taking broadband. It added that the company will look to offer small-medium sized businesses broadband over the next six months. With an aggressive store expansion strategy and expectations for the continued strong growth in handset sales and mobile connections in Europe the outlook for CPW's retail operations is encouraging. 80% of the group's operating profit comes from its Distribution/retail network.
- June results: CPW will report its FY results on June 6 and with numbers unlikely to disappoint focus will centre on comments regarding the broadband rollout. CPW recently said on that, so far, take up for its Free Forever package has been five times greater than expected, and we would expect further elaboration on this at the results.
- High growth: Because of the extensive expenditure required in CPW's broadband roll-out over the next 2 years we look to earnings for 2008-09 to appreciate the potential of its Free Forever package. Our price target of 375p is based on 15x March 09 EPS of 25p. Our valuation of represents a 10% premium to its peers in the non-food retail sector but we feel it is justified by its superior growth potential. **BUY**

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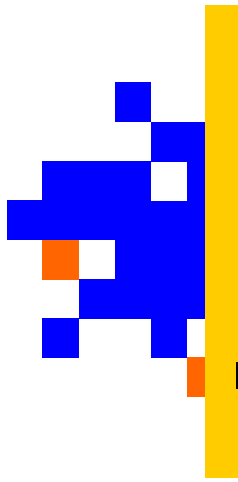
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Trading ideas for the week (continued)

BOI (€14.86) Preview of FY results

- Results preview: On 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.

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