

Weekly Traders Update



15 May 2006

Brief Market View

Equity markets have continued to sell-off. Markets had rallied strongly in recent months but the unclear message from the Fed suggests that US interest rates may peak at 5.5% and European rates at 3.5%. Markets had assumed an inverted yield curve but all time highs in commodity prices and a €/USD rate of 1.29, combined with geo-political concerns over Iran led to inflation concerns and weak bond prices last week. Equity markets reacted to this at the end of last week and have fallen circa 7% peak to trough.

The basic resources and oil sectors have been particularly weak. These sectors together, account for 25% of the FTSE 100 and accounted for at least 50% of the rise in the FTSE 100 in the first four months of the year. The surge in commodity prices in recent weeks to multi-year highs has fuelled this out-performance. This morning however we have seen commodity prices fall by up to 5% and has resulted in a corresponding fall of 5% to 7% in the underlying basic resource stocks. Oil is also lower today and has resulted in a 2% fall in oil stocks.

The Fed are now so sensitive to economic data releases, this week could be particularly significant as the two key inflation readings namely PPI (Tuesday) and CPI (Wednesday) are due for release in America.

Given the current level of uncertainty investors are asking two questions:

1. What is the current Dolmen view of markets?
2. How should I trade the current market?

Dolmen View

This is a sentiment correction not an earnings event. Interest rates and higher commodity prices will adversely affect some company's earnings but first quarter earnings from the S&P 500 averaged 14%, well ahead of the 12% forecast. Results from Irish, UK and German companies have also been well ahead of expectations. The dividend yields of stocks are higher than historic norms. Corporate debt spreads show no deterioration in fundamentals. P/e's are not very demanding. Therefore as this is a sentiment driven correction, it is simply unwinding some of the overbought nature of indices. Such corrections are typically 5-9% in severity.

While there is no doubt that equity markets are entering a difficult period in the short-term, it is consistent with our view that further market upside in 2006 would not be without interruption. These periods of weakness, while unwelcome, are inevitable in any rationally functioning market. We remain happy with our year end forecasts of :

Equity Market Forecasts 2006				
Item	ISEQ	DAX	FTSE	DOW
Forecast 2006 close	8,500	6,400	6,400	11,700
Current Levels	7,710	5,849	5,844	11,395
Target Upside	10.30%	9.40%	9.50%	2.70%

Trading current markets

While markets do present difficulties, they also provide opportunities to find lower entry levels into preferred sectors and stocks, but it also helps investors evaluate the make-up and risk profile of their current portfolio. The first question will be answered by closer examination of a client's specific portfolio. Clients should evaluate their holdings and determine the rationale for holding the stocks they current own. Any holdings that are being held on anticipation of some external event, specifically a take-over, should be re-evaluated or those for example with speculative exposure to the oil price, such as resource companies without validated levels of probable reserves. Equally Banks will outperform insurers during this period.

The stocks that will find most favour in the current period of market weakness are those with solid earnings with an attractive valuation and attractive yield. As a result we favour banking stocks (HBOS, Bank of Ireland), pharmaceuticals (GlaxoSmithKline, AstraZeneca), telecoms (BT and Vodafone), oil (BP, Sterling Energy) and insurance (Aviva, Legal and General). Also with the oil price weakening the stocks like Ryanair and British Airways, both of which are extremely profitable, should benefit.

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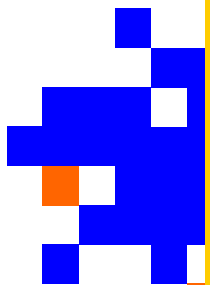
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Earnings Calendar

Date	Company	Event
15-May	DCC	FY
15-May	Eircom	FY
16-May	Glanbia	AGM
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16-May	Providence	FY
18-May	Kerry	AGM
18-May	Wm Hill	AGM
19-May	BA	FY

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Trading ideas for the week

Adidas (€167) Upgrading price target

- Q1 Results: On Tuesday morning, Adidas reported better than expected Q1 results. Sales grew by 47% €2.459 bn and beat forecasts of €2.334 bn. Q1 operating profit jumped 21% to €248m, beating forecasts of €227m. Net profit also beat expectations, coming in at €144m, compared to forecasts of €128m.
- Order backlogs: Order backlog at Adidas was up 12% for the period, ahead of expectations of c.9%. At Reebok order backlog was down 14%, but was a more encouraging number than the 19-20% decline which had been expected. The company added that it expected a positive order backlog at Reebok at the end of 2006. This would represent a remarkable turnaround from the 22% decline reported at the of 2005.
- Raised guidance: Adidas has raised its target for sales of football merchandise this year to €1.2bn, compared with a previous forecast of €1bn, on the back of strong demand for its World Cup 2006 products. The company was also upbeat in its outlook for the rest of the year, reiterating its 2006 guidance of strong double-digit sales growth and double-digit net income growth. Adidas added that the integration of Reebok remains on track and the group as a whole is well positioned for next month's World Cup in Germany.
- Share split: Later today shareholders in Adidas will vote on a proposed four-for-one share split. This move should improve liquidity in the stock and make the shares more attractive to private investors.
- Price target upgrade: In the wake of Tuesday's announcements we are upgrading our 12 month price target from €175 to €190. The revised price target is based on 15x 07 EPS of €12.70 (previously €12.50). This valuation would place shares in Adidas at a slight premium to those in Nike (14x 07) and at a discount to Puma (17x). Given Adidas' superior earnings growth (+20%) over its peers (Nike +4% & Puma +12%) we feel that the 15x multiple is achievable. **BUY**

BOI (€13.89) 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**.

AstraZeneca (2,827p) Buying opportunity

- Short-term trading idea: Shares in AstraZeneca have underperformed recently on the back of a combination of disappointing developments for some of its potential blockbuster drugs and unfavourable currency movements, overshadowing impressive Q1 results reported at the end of April. Despite some concerns over the company's product pipeline and patent expiries, the company is underpinned by sound fundamentals and an attractive valuation, and the recent share price weakness presents a decent buying opportunity.
- Valuation: Earnings are expected to grow by between 10 and 15% in 2006 and 2007, however the shares trade on 14.7x 2006 earnings of \$3.71 and 14x 2007 earnings of \$3.91. This represents a discount of 20% to its European peer group, which seems severe given that pipeline issues exist for the majority of pharmaceutical companies. At current levels AstraZeneca is the most attractive yielding stock in the sector (3.0%), while during 2005 some \$4.7bn was returned to shareholders via dividends and share buybacks. For 2006 this figure is likely to increase to \$5.5bn.
- Upcoming newsflow: The upcoming business review day on June 8th is likely to focus on the recent positive outcomes data for Crestor and Phase II assets such as AZD2171 (cancer) AZD6140 and in-licensing activity. The company will report Q2 results on July 27.

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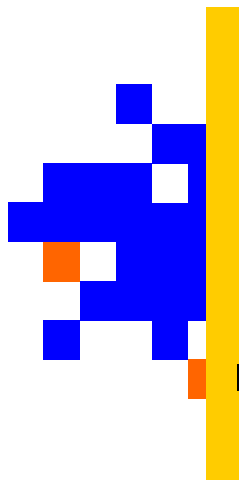
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Trading ideas for the week (continued)

RBS (£17.11) Upgrading from NEUTRAL to BUY

- Management meeting: Following our recent investor meeting with Group Finance Director, Guy Whitaker, we are this morning upgrading our RBS recommendation from NEUTRAL to BUY. Our new 12 month price target of £20.50 (14% upside), is based on 10x 2007 underlying eps of 205p. Our 2006 eps forecast remains 190p, representing 8% growth on the 2005 result of 175.9p.
- Savings growth: In line with recent results from the UK life insurers, it was confirmed that sales of savings and deposit products are very strong currently, resulting in the bank's liability growth exceeding its loan growth. When combined with a steepening US yield curve, this should ensure that there is no further significant erosion of the group's net interest margin in 2006. This was one of the main reasons why we had been recommending some profit-taking in recent months.
- Deal risk: It was also clearly stated that all of the group's growth targets could be achieved organically from its UK and Irish, US and Chinese operations and that the current share buyback programme would continue. If the upcoming IPO of the bank's Bank of China investment results in RBS diluting its shareholding below 5%, then this could provide further reassurance that the risk of a major RBS deal over the next 12 months is very low.
- Personal exposure: Despite recent press coverage of the Q1 rise in UK personal insolvencies, it was also confirmed that RBS has suffered no material deterioration in personal lending credit quality recently. Its lower than sector average exposure to unsecured personal lending of c.7% of global loan book provides some important protection from this risk.
- Recommendation upgrade: In addition to the upcoming Bank of China IPO, which recent press coverage has reported will show a trebling of the initial value of the RBS investment a year ago, another near term positive catalyst for the RBS share price could be the bank's H1 trading statement on 8th June. Therefore, ahead of the very often seasonally strong month of June for the RBS share price, we this are this morning once again upgrading our recommendation from NEUTRAL to BUY, with a new 12 month price target of £20.50 (14% upside), which is based on 10x 2007 eps of 205p : BUY.

Lloyds-TSB (499p) Attractive buying opportunity

- UK growth : Lloyds TSB announced profit before tax and eps of £3.47 bn and 44.6p respectively for the year ended 31/12/05. These results were ahead of consensus forecasts of £3.315 bn and 42p, and were year on year increases of 4% and 8%. The results showed modest retail banking growth and good cost control being less offset by higher bad debts than had been expected.
- SW recovery : 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.
- Attractive yield : 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. With an above average probability of a 2006 takeover approach, an attractive dividend yield of **6.8%**, and a stand-alone ex-dividend fair value per share of £5.70, based on 12x 2006 eps of 47.5p, our view is that the market sell-off of recent days has generated a very attractive buying opportunity in Lloyds TSB at current levels : **BUY**.

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