

# Weekly Outlook



17 July 2006

## Brief Market View

US stocks led the way lower last week, as has been the pattern of recent months. Solid Q2 results from General Electric on Friday failed to halt the slide as the escalation of Middle East violence pushed the oil price to a record high. Next week, a large number of Q2 earnings reports will be released, which will be eagerly watched for signs of a slowdown in corporate earnings growth. The UK market also sold off last week, even though the market's heavy oil sector weighting protected it from the worst of the international weakness. Standard Life's IPO got off to a good start, with the shares initially trading 5% higher, and Aviva announced the acquisition of US life insurer, AmerUS, for \$2.9 billion. On the Irish market, Abbey's full year results came in below forecasts, and Greencore's share of the European Union restructuring fund also disappointed. However, Grafton's trading statement on Friday confirmed that the group continues to perform in line with market expectations.

Although a whirlwind of bad news and deepening uncertainty sent stocks tumbling last week, Wall Street could see a return to reason in the week ahead with a fresh round of economic and earnings data that could help investors regain their footing.

In terms of economic data to keep an eye on this week, the spotlight will be on Bernanke, who delivers his semi annual testimony to the Senate Banking Committee on Wednesday. He is unlikely to stray too far from the June FOMC statement, which suggested less of a bias towards tightening. Certainly, recent survey and activity data indicate a cooling in activity.

In the UK, markets will be looking to the minutes of the July MPC meeting for direction. The key focus for markets will be whether the tone of discussion supports their expectations for a rate hike. We think there will be little sign of a rush to change policy, which could leave sterling vulnerable.

Ahead of Mr Bernanke's semi-annual testimony to Congress on Wednesday afternoon, inflation numbers are likely to get plenty of attention in the week ahead. As well both June producer and consumer prices in the US (Tuesday & Wednesday respectively), we get euro area and UK CPIs on Monday & Tuesday respectively.

The semi-annual testimony is often used by Fed Chairmen to outline policy expectations and expand on the methodology the Fed uses to assess the economy. We expect Bernanke to reiterate the Fed's recent statement, that policy will continue to be data dependent.

But there is little to suggest that either of the two new members will ignite the policy debate, making it more likely that interest rates stay on hold for the foreseeable future.

Meanwhile, the impending flood of profit reports may calm worries about the shaky start to the second-quarter earnings season, or confirm fears that rising energy prices and lending rates are finally taking a toll at the corporate level.

The coming week will see a blitz of numbers, with earnings reports scheduled from Dow components Microsoft, IBM, Johnson & Johnson, Caterpillar and Honeywell. Apple and Google are among the major technology names set to post their quarterly results, along with Intel.

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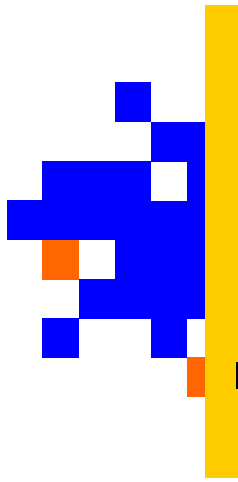
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## Earnings Calendar

<u>Company</u>	<u>Date</u>	<u>Event</u>
Citigroup	17-Jul	Q2
J&J	18-Jul	Q2
BSkyB	18-Jul	Investor Day
IBM	18-Jul	Q2
Rio Tinto	19-Jul	Trading Update
Intel	19-Jul	Q2
Apple	19-Jul	Q3
Iora	20-Jul	Q2
Google	20-Jul	Q2
Microsoft	20-Jul	Q2
Honeywell	20-Jul	Q2
Caterpillar	21-Jul	Q2
TrinityBiotec	24-Jul	Q2
Vodafone	24-Jul	KPIs
GSK	26-Jul	Q2
AstraZeneca	27-Jul	Q2
Ryanair	31-Jul	Q1

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### Trading ideas for the week

#### Abbey (€ 8.56)

#### Results below forecasts

- **Margin declines** : Last week Abbey announced results for the year ended 30/04/06 which were below consensus forecasts. Eps of 113.8c was c.8% below the consensus forecast of 124c, and was a year on year decrease of 13%. The main reason for the earnings decline was a 4.8% fall in the group's house-building margin from 28.4% to 23.6%, as a result of higher land costs. Some minor margin decline had been expected as a result in a change in the company's sales mix towards lower margin developments, but the size of the squeeze from higher land costs was a negative surprise.
- **Completion delays** : During the year ended 30/04/06, Abbey's completions were 1% lower year on year at 718. Even though the company noted that market conditions in the UK have improved, with H2 UK completions rising by 36% to 229, Abbey also announced that delays in the completion of recent land purchases would "hold back" unit closings in Ireland this year, and delays in achieving a building permit would result in the company's Prague scheme not starting until next year.
- **Asset value** : However, higher land costs also imply that the market value of the group's land-bank, which already has planning permission for 2,588 plots, is significantly more than the c.€82k per plot at which it is currently valued in the group's reported NAV per share of €7.59. Abbey's average selling price for the year was €255.6k, which at a house-building margin of 23.6% implies an average unit cost of €195.3k. Even assuming an average market value per plot of €100k would boost group NAV per share from €7.49 to €9.16. Another source of potential NAV growth over the next 12 months is the company's 12 plant hire sites in the UK. Abbey is currently seeking change of use permission in relation to several of these sites, which could then be used for homebuilding.
- **Share buybacks** : With Abbey's year end net cash balance €67.7m, there is the potential for further share buybacks over the next 12 months, subject to the necessary EGM authority being achieved. Following the buying back and cancelling of shares worth €40.5m during the year ended 30/04/06 at an average cost of €9.20, there are now only 29.7m shares in issue. A further €9.4m spent buying back and cancelling shares at current levels would further boost the group's market value NAV per share from €9.16 to €9.50.
- **October dividend** : Therefore, despite the near term earnings' disappointment, there remains attractive asset value hidden within the group. Abbey will pay a dividend yield of c.4% for waiting for this upside to be realised, with a final dividend of 24c per share going ex and being paid in October. As a result, we downgrade our current 12 month price target from €10.50 to €9.50 (11% upside), but reiterate our current BUY recommendation.

#### Blackrock (39c)

#### Initiating Coverage

- **Recent performance** : The share price of Blackrock International Land, the Fyffes's property spin-off has outperformed the Irish market since its listing on 15th May (+11% v -1%). Even though the share price may have limited further upside in the short term, an examination of the company's property portfolio indicates the potential to create substantial further NAV growth over the next 2 years.
- **Buoyant markets** : Given the buoyant outlook over the next 2 years for the property markets of Ireland, Northern Ireland and the UK, the company's property portfolio would appear to have significant upside potential from the April 2006 valuation reports compiled by Lisney, BTW Shiels and Lambert Smith Hampton. These valuations are contained in Blackrock's prospectus dated 13/04/06, and the buoyancy of these property markets continues to result in achieved market prices significantly exceeding valuations contained in such reports.
- **Limited downside** : Despite the out-performance of recent months, Blackrock's current NAV per share of 37c limits downside risk for the share price. This NAV per share is made up of properties worth €215.5m (after the recent acquisitions of €9m), net cash of c.€11m and a deferred tax liability of €10m, divided by the 583.26m Blackrock shares in issue.
- **Attractive upside** : However, in addition to there being limited downside risk to the share price from current levels, there would appear to be attractive upside potential over the next 2 years from synergistic bolt-on acquisitions, combined with more efficient utilisation of the company's existing sites. An example of such a synergistic acquisition was the recent purchase of 31 acres at Broxburn, 13 miles west of Edinburgh, as part of a €9m announcement, which also included the purchase of a 34,000 sq ft warehouse in the Dublin's Wilsborough Industrial Estate.
- **NAV growth** : Our recommendation is based on a 2 year investment horizon as a result of the lengthy time periods required by the planning process. Our view is that Blackrock's current NAV per share of 37c has the potential to grow by 20% per annum over the next 2 years to 53c. Given that the UK property sector average currently trades at a 10% discount to NAV and that the UK property sector historical average discount to NAV over the past 25 years has been c.10%, our initial 2 year price target of 48c (23% upside) is based on a 10% discount to NAV per share of 53c as at 30/06/08 : Long term BUY.

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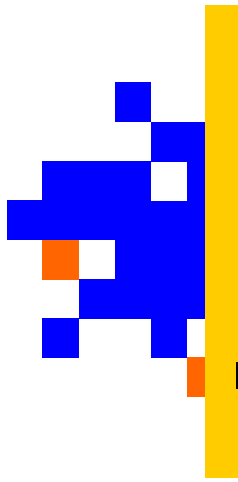
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### Trading ideas for the week (continued)

#### Standard Life (£2.37) IPO trades higher

- Trading higher: Standard Life's IPO has got off to a good start, with the shares trading c.5% higher than the £2.30 offer price. This means that when the preferential offer price discount of 5% is also taken into account that investors have already made a gain of 10% on the effective £2.19 cost price of additional shares subscribed for.
- FTSE eligibility: A share price of £2.41 values the shares at an 8% discount to 2006 year end embedded value per share of £2.63, and gives SL a market capitalisation of £4.8 bn, making it eligible for FTSE 100 membership.
- Discount valuation : SL is now targeting a return on embedded value for 2007 of between 9% and 10%, following the announcement of a pre-tax value of new business of £30m for Q1 2006. This would be a c.30% lower than the UK sector average 2006 return on embedded value of 13.9%. Discounting the current UK sector average price to 2006 embedded value (EV) of 1.4x by 30% would give a price to 2006 EV of 1x. Given that Standard Life has a high quality pension offering and a fast-growing asset management business, the company should not be valued any lower than its 2006 year end EV of £5.269 bn.
- Attractive upside : This translates into a 2006 year end EV per share of £2.63, generating our initial 12 month price target of £2.60 (10% further upside). SL management has stated that the first dividend of 5.4p for H2 2006 will be paid in May 2007 and that it will pursue a progressive dividend policy. This is expected to represent c.50% of the 2006 full year dividend, implying a dividend yield of c.4.5% on the current share price. Investors still holding the shares in 12 months time will also receive an additional 5% bonus in the form of 1 extra share for every 20 still held : **BUY**.

#### Aviva (£7.25) US deal would boost growth

- Major deal : Aviva has confirmed that it is in talks to acquire US life insurer, AmerUs Group, which at c.£1.5 bn would be the company's largest deal since 2000. Aviva recently stated that it was looking to the US market for acquisition opportunities.
- Track record : The US market has c.1000 life companies, is the world's largest savings market and has strong growth potential as a result of the ageing population. In such a market, Aviva's excellent acquisition track record and disciplined capital allocation should ensure that any deal will boost the group's earnings growth prospects. A deal price of £1.5 bn (c.12.8x 2007 eps), would boost Aviva's 2007 eps by c.2%.
- Growth market : In addition to being a top 5 player in the high growth US indexed annuity market, Aviva would benefit from the fact that AmerUs owns much of its own distribution. With only 4% of Aviva's international life and pension sales in the US, such a deal would also significantly improve Aviva's current under-representation in the US market.
- Buying opportunity : Therefore, even though up to half of the purchase price (c.£0.75 bn) may be funded by a share placing, the current resultant share price weakness has generated an attractive medium term entry level in a group with a track record of successful acquisition integration.
- Bid potential : Our current view is also that if this latest takeover approach is unsuccessful, then the end result could be that Aviva itself ends up receiving a takeover approach, particularly following the failed £7.08 per share approach to Prudential earlier this year. This is because the offers confirm Aviva's ambitions of building a global and US presence, and its European exposure may be of interest to either AIG or AXA.
- Stand-alone value : However, even on a stand-alone basis, Aviva's share price would appear to have significant 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.
- Attractive upside : Therefore, our current 12 month price target for Aviva of £8.50 (17% upside), is based on 1.6x 2006 EV per share of £5.30. Aviva shares will also pay investors a dividend yield of c.4% for waiting for this upside to be achieved : **BUY**.

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