

Weekly Traders Update



20 Mar 2006

Brief Market View

A pretty light week on the economic data front this week however the main focus will be US Durable Goods (Friday) and Producer Prices (Wed). The next major event in the US will be the meeting of the Federal Reserve on Tuesday 28th March. The Euro is trading at a 2month high against the Dollar, driven by higher interest rate expectations in the Eurozone. Interest rate futures are now expecting European rates to be at 3.25% by year end. Mr Bernanke is speaking this evening in the US and the market will be closely watching for any comments regarding the future direction of US Rates. A massive US current account deficit of \$68.5bn and a pretty benign Inflation number prompted the initial sell off in the Dollar early last week. Equity markets did well last week driven by strong corporate earnings (US Investment Banks) and renewed M&A activity. The Insurance sector is in focus today with the £17bn all cash bid by Aviva for Prudential. Prudential shares have spiked 12% this morning but management have rejected the bid. The news has pushed the Insurance sector higher with Friends Provident (+3%), Legal & General (+5%) and Irish Life & Permanent (4.6%) all rallying following this morning's announcement. Comments from Spains BBVA Bank regarding their commitment to a European Banking acquisition has pushed Lloyds up 3% this morning to 569p. In Ireland, Independent News & Media report earnings on Wednesday morning and we are expecting a positive update from the group. Highlights in the UK this week will be earnings from Wolseley, Kingfisher (Tues), Imperial Tobacco (Wed), Friends Provident (Thurs) and Next (Thurs). In Ireland we are buyers of Bank of Ireland (ahead of trading statement Tuesday week), Fyffes, Kerry Group, Paddy Power, Abbey and Independent News & Media. Our preferred picks in the UK are British Land, AstraZeneca, Glaxosmithkline, William Hill, BHP Billiton, Legal & General, Lloyds, HBOS and Reuters. European names that are on our buy list currently are BMW, Adidas, Deutsche Bank and E.ON.

British Land (£11.87) Price Target Upgraded to 1375p

Budget catalyst: This Wednesday, 22nd March, UK finance minister Gordon Brown, will present his annual budget. This year's Budget Bill is expected to include the final version of the UK REIT legislation. If this version shows some flexibility on the previous version that would make it easier for British Land to meet the qualification requirements, then Wednesday's announcement could be a positive catalyst for the share price.

Potential flexibility: The previous legislation included a 2.5x interest cover minimum and a 10% single shareholder maximum. New flexibility in this area could include reducing this interest cover minimum or using an alternative gearing measure such as LTV, as well as allowing a grace period for the 10% single shareholder rule. The new UK-REIT structure is due to be effective for UK property companies from January 2007.

Tax benefits: The new UK REIT legislation could result in some important tax benefits for the UK property sector. As currently drafted, UK property companies will no longer be liable for CGT on property sales, with the distribution of these gains only liable to UK withholding tax at 22%. They will also be able to distribute 95% of their net profits after capital allowances, which should significantly boost dividend yields paid.

Q3 NAV: Last month, British Land reported a NAV per share of £13.90 as at 31/12/05, a strong 11% increase on the £12.56 per share as at 30/09/05. We see the potential to achieve further NAV growth over the next 12 months from the sale of some of the group's high street retail properties. Following a recent strategic review of its property portfolio, British Land has started selling some of its high street retail properties as a result of the buoyant market for such properties. Sector discount: Over the next 12 months, a conservative assumption is that the group's NAV per share will grow by a further 10% to £15.29. Over the past 25 years, the historical average discount to NAV for both British Land and the UK property sector has been c.10%, and the current UK property sector discount to NAV is 10%.

Further upside: As a result, ahead of this week's UK Budget, we now upgrade our current 12 month price target for British Land from £12 to £13.75 (16% further upside), which is based on a 10% discount to a forecast NAV per share for the group of £15.29 as at 31/12/06.

AstraZeneca 2874p

AstraZeneca is the second largest UK pharmaceutical company (by sales) with products concentrating on Cardiovascular, Gastrointestinal, Neuroscience, Oncology, Respiratory and Inflammation, and Infection. The company recently released results for the year ended 31/12/05, which saw sales increase 12% to \$23.95bn with EPS up an impressive 27% to \$2.91, in line with the company's guidance of \$2.85 to \$2.95. The company reported strong Q4 sales of all its blockbuster drugs with Crestor \$1.3bn (+38%), Nexium \$4.63bn (+18%), Arimidex \$1.2bn (+44%) and SeroquelTM \$2.76bn (+35%). Market reaction to the results however was muted as concerns about the company's product pipeline became the main focus for investors. News that the company was withdrawing its post-operation, anti-clotting drug Exanta, did little to reassure investors, while a court ruling on possible generic competition against its hypertension drug Toprol added to the company's woes. The market reaction to all this negative product news has been understandably negative with the shares now down 11.5% from its early January level of 2916p. Following the recent results from AstraZeneca and the subsequent share price weakness, the shares are now looking attractive on fundamentals. Earnings are expected to grow by between 10 and 15% in 2006 and 2007, however the shares trade on 13.8x 2006 earnings of \$3.23 and 12.9x 2007 earnings of \$3.49. This represents a discount of 19% 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 stocks in the sector (3.4%), 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. AstraZeneca is certainly not unique in facing the patent and pipeline issues, however recent news-flow has focused greater negative investor concerns on the stock.

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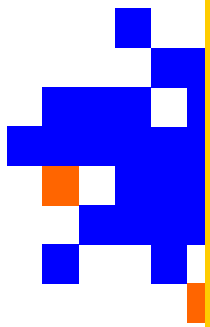
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BHP Billiton 981p- Top pick in the UK Mining Sector 1100p target.

BHP Billiton is the world's largest mining group. The group's operations are divided into seven Customer Sector Groups (CSG): Aluminium, Base Metals, Carbon Steel Materials, Diamonds and Specialty Products, Energy Coal, Petroleum, Stainless Steel Materials. **Results:** BHP Billiton reported attributable profit (pre-exceptionals) of US\$4.4bn for the six month period ending December 2005, in line with market consensus. Operationally, better than expected results from Base Metals, Petroleum, Diamonds & Specialty, while Aluminium, Stainless Steel and Energy Coal were marginally weaker than forecasts. BHP declared an Interim dividend of US\$0.175, representing a strong year on year gain of 30%. In addition, BHP Billiton committed to a \$2bn global share buyback. **Costs Higher:** The US\$795m increase in costs from the previous December half was an increase of circa 8% across the business. The biggest drivers were the largely uncontrollable impact of higher raw material and energy prices. Labour and contractors was also a significant contributor to higher costs driven by the increased use of, and higher cost of, contractors. Particularly in the Australian iron ore and coking coal assets where costs were up 20% and 30% yoy, respectively. **Outlook:** The group remained bullish on the outlook over the next two years. Key points from the outlook statement were that management expect (1) Strong global, and in particular Chinese growth (2) Expect reasonable recoveries in Japan and Europe, US economy moderating Overall. BHP Billiton predicts strong market prospects for FY06/07. **Production Pipeline:** The 5 major and 2 minor projects approved during the period have increased the size of the project pipeline by US\$2.9b to US\$14.4b. This puts BHP is the strongest position in the sector from a pipeline perspective with production expected to be increased by 35% - 40% over the next 4-5 years as the pipeline is delivered. **Company info:** EBIT by division - Petroleum 21%, Aluminium 6%, Base Metals 28%, Carbon Steel 33%, Diamonds 4%, Energy Coal 3%, Stainless Steel 5%. **Valuation:** BHP trades on 12.5x FY2006 earnings and currently is yielding 2.75% BHP is the most diversified mining stock with also good exposure to the Oil sector. **Buy sub 950p**

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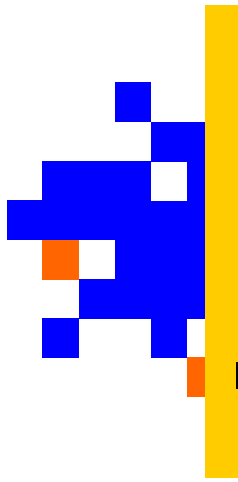
E.ON (€93.55) Compelling valuation and Dividend Yield of 7.73%

German utility group E.ON today confirmed preliminary results for 2005 with EPS of €11.24 up from €6.61 a year earlier, boosted by a €3bn book gain from the divestment of the real estate unit Viterria and Ruhrgas Industries. Net Profit came in at €7.4bn from €4.3bn a year earlier. At the same time the company said that 2006 net profit would be lower than 2005, but the company's power and gas businesses would continue to drive operating-earnings growth. Recurring EPS (stripping out exceptionals) for 2006 is forecast to come in at €6.63 per share compared to €5.77 for 2005, an increase of 14.9%, while for 2007 recurring EPS is forecast to be €7.99. This leaves the company trading on 13.8x and 11.4x 2006 and 2007 earnings respectively, a discount of 17% to the European utility sector. **M&A Involvement:** E.ON has a cash pile of €12bn and has recently secured a €32bn credit line. Earlier speculation that it was to buy UK utility Scottish Power came to nothing, and recently E.ON has launched a record breaking €32bn bid for Spanish peer group Endesa. Political opposition to the bid from the Spanish government has thrown the bid into question, however today E.ON restated its intention to pursue the bid. This statement raised concerns in the market that it may lift its offer, and consequently over-pay for the Spanish company. The company however clarified this statement by saying it would not raise its bid, stressing that political interference in the bid was unnecessary. Since the bid was announced and subsequently fears increased E.ON might pay a higher price, E.ON's shares have fallen from €98.77 (on 21/2/06) to their current level of €90.45. Price targets however of up to €117 have been placed on the shares, as the market believes that the management will not jeopardise future earnings growth by over-paying for assets. **Attractive Yield:** E.ON recently announced the intention to pay €4.25 by way of a special dividend, after it disposed of its shareholding in industrial gases group Degussa. Along with this special payout, the company also declared a full year ordinary dividend of €2.75. The combined value of these dividends is €7, with an ex-dividend date and pay date of 5th May 2006. This gives an attractive Gross Yield of 7.73%. This yield, along with the strong balance sheet, strong funding position and the strong growth potential for the company make the shares an attractive buy given the recent price weakness. For long-term portfolio clients, the yield alone is compelling.

BP 664p Compelling valuation and strong fundamentals BUY

Recent Results: Q4 Clean Net Income (pre-exceptionals) came in at \$5.3bn, 6% below consensus of \$5.6bn, however this was still a 22% increase on the corresponding period for the previous year. There were however a number of items which impacted on this number, specifically (1) a \$950m pre-tax hit from Gulf of Mexico Hurricane damage (Thunder Horse platform), (2) an \$870m impact from the Texas Refinery explosion and (3) \$467m of rationalisation costs. All very negative on initial reading, and obviously the points the market focused in on at the time of the results. These however are all largely one-off items which should not be experienced again in the current year. The only on-going issue with any of the above is the delay in getting the Thunder Horse platform back fully operational, although this should be resolved by the end of Q1 2006. That was the bad news. Now for the good news: **Reserve replacement:** Company confirmed that it managed to replenish oil and gas reserves by 100% in 2005 on a UK reporting basis, and 95% on a more stringent SEC basis. This compares very favourably with a reserve replacement figure of just 70% for Royal Dutch Shell in 2005, while BP have forecast reserve replacement of up to 1335% out to 2010, compared to a 75% figure for Shell. **Capital Position:** 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. **Capital Spending:** The company is expected to spend \$15bn in 2006 rising to \$16bn by 2006. This shows a clear commitment to continue to grow the business and actively seek to grow the reserve base. **Divestments:** In line with its policy to maintain a strong reserve base and replace diminishing assets, the company has committed to a \$3bn a year divestment programme on an ongoing basis. **Refining Margins:** The negatives cited above, while obviously a negative on the overall bottom line were off-set by an improvement in refining margins and by the higher price of the basis oil and gas commodities. **Valuation:** BP trade on a 2006 P/E of 11.9x and on 10.4x 2007 earnings. This represents a 10% discount to the European Integrated Oil sector and a discount of almost 20% to the FTSE 100. The shares have fallen 5.5% since the release of the results on 7/2/06 compared to a fall in the oil price of just under 3%, and compared to a gain for the FTSE 100 of 2%. Given the company's strong reserves, strong margins, strong free cash flow (FCF Yield 8.5%) and a not unreasonable 3.5% dividend yield the shares, the recent share price weakness represents a good buying opportunity.

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Kingspan €12.50 2005 results show 40% growth prompting price target upgrade to €13

Results announced: Kingspan recently announced results for the year ended 31/12/05. Profit before tax and earnings per share of €134.997m and 66.4c were largely in line with consensus forecasts of €134.3m and 65.4c, and were year on year increases of 40% and 41%. **Insulation growth:** Such strong growth was driven by the group's insulated panels business, its insulated boards business and its structural business, which includes Century Homes. The increasing importance of energy conservation because of high energy prices is driving strong sales growth at the insulated panels business. The increasingly tight regulatory environment is driving strong sales growth at the insulation boards business, with new regulations applying to UK planning permissions from April 2006 expected to further boost demand from 2007. Kingspan has established leading positions in several European insulation markets. **Acquisition growth:** The inclusion of Century Homes, acquired in April 2005, also helped to drive very strong growth at the group's structural business. Given Kingspan's strong capital position, with interest cover of c.14x, there is the potential for further such acquisitions in 2006 resulting in earnings upgrades. With the group's raised access floor business remaining weak in recent years, there is also the potential for group growth to be further enhanced in 2006 and 2007 as this business starts to recover. **Margin expansion:** In addition to strong sales growth, Kingspan is also achieving some margin expansion currently, an increasingly rare combination in the building materials' sector. Its H1 2005 results showed higher input costs being successfully passed on, and manufacturing efficiencies helping to increase the group's H1 2005 gross margin to 30.3%, from 29.5% for full year 2004. Kingspan's H1 2005 EBITA margin also increased to 11.5% from 9.9% for H1 2004. **Further upside:** As a result, our view is that further strong average earnings growth of 16% can be achieved over the 2006 / 2007 period. Such strong growth justifies a premium rating and so our current 12 month share price target of €13 (4% further upside) is based on 15x 2007 eps of 86.4c. **HOLD**

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Irish Life & Permanent €18.80 Price rallies on UK M&A activity...Aviva bid for Prudential

Results announced: Irish Life and Permanent announced its results for the year ended 31/12/05 two weeks ago. Operating profit before tax and earnings per share of €420m and 135c respectively were ahead of consensus forecasts of €407m and 128.7c, and were both year on year increases of 9%. The main area of positive surprise was a particularly strong December for retail pension and bond sales, which given the higher margin nature of these products and the fact that most of the bond sales took place through the group's bank branch network, helped achieve a higher than expected group life margin. **Bancassurance distribution:** This overall group life margin increased to 20.4% from 14.9% for 2004, and the 26% growth in bancassurance sales (the group's highest margin distribution channel) was a key factor in helping to achieve this margin expansion. The group's leading share (c.27%) of the Irish life and pensions market leaves it well positioned to profit from the continued growth and ageing of the Irish working population. **Mortgages stronger:** Recent data for Irish mortgage lending points to that market remaining stronger for longer, which should help achieve an acceleration in group earnings growth in 2006. We are currently forecasting 10% eps growth in 2006 to €1.49. Slightly higher interest rates and current account market share gains should also help to offset some of the margin pressure at the banking business. **Allianz value:** Valuing the group's bank business at 12x upgraded 2006 earnings to reflect its continued strong growth gives a per share value of €6.53, valuing the group's life business at 1.8x embedded value per share of €6.26 to reflect its above average future growth prospects gives a per share value of €11.27, and valuing the group's 30% interest in Allianz Ireland at 10x 2006 earnings (a discount to FBD's current 12x), gives a per share value of €1.67. **Further upside:** Summing these 3 different parts gives a per share value for the group on a stand-alone basis of €19.50. Approximately 70% of this dividend (42.8c per share, representing a yield of 2.4%) will be paid to shareholders holding the shares on 26th April. **BUY.**

BMW AG €42.85 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.

ADIDAS €164.50 Recovering well, Buy ahead of Worldcup 2006.

After a poor week last week, Adidas has recovered well today following a number of upgrades by European Brokers. Our buy rating on Adidas is maintained and is focused on strong revenue growth, significant earnings enhancement from the Reebok deal and a positive earnings kicker from World Cup 2006 this summer. Management expects to gain EUR125m via integration synergies and we are expecting further update at the Adidas Capital Markets day in London on April 11th.

William Hill 579.5p Cheltenham proves a good results for the Bookies.

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.

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