Weekly Traders Update

DOLMEN STOCKBROKERS

26th Sept 2005

Brief Market View

Hurricane Rita caused a significant amount of damage in the US over the weekend but was not as destructive as had been feared. European equity markets have opened strongly this morning as a result. Crude oil is off almost $5 from Fridays highs, trading at $63.50 this morning, with the majority of oil refinerys managing to avoid the full impact of Hurricane Rita in the Gulf of Mexico. The US Dollar has continued its move higher despite the turmoil caused by Rita. US Bond yields have moved 20 basis points higher over the past week as inflationary fears prompted investors to sell Bonds and push near term expectations of US interest rates higher. A break below 1.20 in Euro/USD could see the Dollar rally further near term on technical buying. Sterling weakened last week following the release of the Bank of England MPC minutes that indicated the member voted 9-0 to keep UK rates on hold at 4.50%. Some commentators are expecting another rate cut before year end following some weak economic data and high levels of consumer debt. We expect UK rates to remain unchanged near term. A quiet week for economic data with US Consumer confidence (e 95) due on Tuesday which is likely to reflect the spike in the oil price and the turmoil caused by Katrina. US Durable Goods Orders for August (e +0.8%) are released on Wednesday afternoon. In Europe, the highlight will be German IFO (Business Confidence) released on Tuesday (e 94.2).

A number of earnings updates are due in **Ireland** this week. IAWS reported full year results this morning with underlying EPS growth up 13.4%. Bank of Ireland issues a pre-close trading statement on Tuesday, IFG reports H1 results on Wednesday and McInerney is due to release H1 results on Thursday. In the **UK,** O2 issues a trading statement on Tuesday morning. Barratt Developments, United Utilities and Scottish & Southern Energy issue quarterly earnings on Wednesday. Boots issues a H1 trading update on Thursday and Man Group issues a pre-close trading statement on Friday.

McInerney Holdings €8.45

On Thursday, 29th September, McInerney Holdings will announce results for the 6 months ended 30/06/05. We are forecasting profit before tax and earnings per share of €20m and 48c respectively, year on year increases of 17% and 15%. UK expansion : The primary driver of this growth will be the UK operations where the group expects to sell 800 homes this year, a major year on year increase of 60%. When combined with sales of c.100 units at its Spanish operations, this international growth will be the main driver of future earnings growth, now that sales at the Irish business are stabilising at c.1,100 units per annum. Last week we upgraded our McInerney recommendation from NEUTRAL to BUY, ahead of the announcement of the group's H1 results on Thursday. **BUY**

IFG Group €1.33

IFG Group will announce results for the 6 months ended 30/06/05 on Tuesday, 27th September. We are forecasting core profit before tax and earnings per share of €5.3m and 6.5c respectively, year on year increases of 10% and 8%. IFG reports core activity figures to enable year on year comparisons to be made before discontinued activities, exceptional items and goodwill. Growth resuming : Such growth will be driven by further impressive performances by the group's International and Irish businesses not being held back by profit declines from the UK operations, as was the case last year. Helped by the appointment of a new CEO for its UK business in September 2004, IFG's UK division, which contains pension release, actuarial and IFA units, should show some recovery in 2005. Mortgages buoyant : IFG's mortgage broker, Mortgage Business Solutions, has already reported a strong 39% increase in business volumes for the first half of 2005. Particularly impressive was the 66% growth in re-mortgaging business. This is because the re-mortgage market is expected to account for 40% of the overall mortgage market in 3 year time from 25% currently, as more Irish consumers re-mortgage to consolidate their debt at lower interest rates. **BUY**

Bank of Ireland €12.85

Bank of Ireland will release its H1 pre-close update on Tuesday, with strength across its domestic operations to remain the key driver of its profits. The statement is likely to highlight the continuing strength of its domestic businesses, i.e. Retail ROI, BOI Life and Wholesale FS. BOI's corporate and Life divisions have both recently reported strong performances in H1. On the subject of margins, given the fact that both AIB and IL&P have both reported healthy H1 margins suggests that there is little risk for any negative surprises for BOI here. Markets will also be focusing on the health of its asset management division BIAM and how the bank has been able to stem the out flow of mandates. However the performance of its UK operations is less certain. Modest profit growth at its UK division's profits is expected. Although the re-pricing of the standard mortgage back book remains an issue, recent newsflow on the buy-to-let market has been more upbeat. News on the Post Office JV will also be eagerly anticipated. **BUY**

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RBS 1610p

Recent weakness : The share price of Royal Bank of Scotland has been very weak in recent days. While some of the usual takeover stories are being put about, given that RBS recently committed to not increasing the level of its Bank of China investment for 3 years, it is unlikely to make any significant acquisitions over the next 12 months. **US exposure** : A more likely explanation for the share price weakness is the bank's US exposure, given the share price weakness of the US retail banks in the aftermath of this week's interest rate increase by the FED, and the knock-on weakness of all of the UK banks. Therefore, RBS' larger than sector average US exposure is the most rational explanation for its greater than sector average recent share price weakness. **Margin concerns :** The rationale for this is the margin erosion caused by the flattening of the US yield curve. In its H1 2005 results' announcement, RBS attributed 0.04% of the 0.23% erosion of its net interest margin to the flattening of the US yield curve, and this week's FED move extends this effect. **Offsetting income :** However, the group's sizeable US deposit base will generate higher interest income as a result of the FED move, and the adoption of Citizen's best sales practices at Charter One should also boost group income. **Net effect :** Recent strong results from the US investment banks could also result in another US income offset this year in the form of better than expected US corporate banking income. Even assuming that the net effect reduces the group net interest margin by a further 0.02% in H2 2005, this would only reduce group earnings by c.1%. **Major upside :** Following last month's c.2% downgrades to 2005 and 2006 forecasts, complicated by IFRS adjustments, the consensus 2005 and 2006 eps forecasts are still £1.76 and £1.90 respectively. As a result, even valuing the bank at a basic sector average multiple of 10x consensus 2005 eps of £1.76 generates attractive 12% upside from current levels. **Attractive yield :** With the 5 year average pe of RBS 10.8x forward earnings, a fairer 12 month share price target would be £19 (21% further upside), based on 10x consensus 2006 eps of £1.90. RBS will also pay a dividend yield of c.4.2% for waiting for this upside to be achieved. **BUY**

O2 152p

O2 will release a pre-close trading statement for 1H06 tomorrow. It should prove to be quite upbeat on the back of recent newsflow and the "increasing confidence" in targets that management cited at the Q1 KPIs in July. For O2 UK, management expects mid-single digit service rev growth and stable margins (30.4%). For Germany, O2 targets further strong growth (+28% in '03/04), and EBITDA margins at c.20%. For H1 '05/06 consensus forecasts point to group revenues of £3.57bn -£3.62bn and EBITDA of £963m-£1.02bn. Other key figures to look out for are net additions and Average Revenue Per User (ARPU). O2 should unveil c.550,000 net new customers in Q2, mostly in Germany (400,000) and the UK (150,000).with strong ARPUs, with the UK at £267, Germany €350 and Ireland €570. O2's exposure to improving UK ARPU dynamics in calendar 4Q05, the possibility of an LBO and its potential attractiveness to an incumbent telecom operator results in limited downside risk from current levels. The stock opened up 4p this morning to 158p on weekend press speculation in Germany that Deutsche Telekom is considering a £18bln bid for the mobile phone operator, which would value the group at circa 200p - 210p. Subsequently Deutshe Telekom has issued a statement saying it has "no interest" in O2 and the stock has fallen back to 152p. **BUY on this mornings weakness**

Boots 625p

Boots is scheduled to provide investors with a pre-close trading update on Thursday, 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. We are expecting a weak set of results from the group on Thursday and would **buy the stock post results on Thursday on weakness.**

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IAWS €11.26

This morning, IAWS announced results for the year ended 31/07/05. Profit before tax and earnings per share of €114.98m and 70.41c respectively were slightly ahead of consensus forecasts of €111.2m and 70c, and were year on year increases of 20% and 13.4%. **Agri weak :** The slowing in the rate of earnings growth to 13.4%, from 17% last year, was caused by the group's Agri division which comprises animal feed ingredients, fertiliser blending and marine proteins. This business continues to suffer from lower farm spending as a result of CAP reform issues. Increased supply chain costs, especially energy, were also a factor in slowing the overall rate of group earnings growth. **Food strong:** The group's La Brea business, in particular, benefited from a full year's contribution from the extra production line completed last year, even though the group's UK Cuisine / Delice business was negatively impacted by a fire at one of its depots which cost the company c.8 months worth of growth. **Recent weakness:** Given the weak profitability outlook of the group's Agri division, as well as the negative impact of high energy costs on supply chain costs, it is difficult to forecast sustainable group earnings growth in excess of the 13% reported in these results. At a PEG ratio of 1.2, this would at most support an earnings multiple of 15.6x current year earnings. **Buyers of the stock sub EUR11; 12 month price target of EUR12.30 is based on 15.6x consensus current year eps of 79c.**

British Land 904p

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**

BOC Group 1144p

Takeover Speculation: BOC's share price has enjoyed strong gains recently on the back of mounting speculation that a £6.7billion bid was imminent for the industrial gases company. Rumours have centered on chemicals group BASF, which is believed to be preparing a share offer of between 1330p and 1350p. However some reports are suggesting that a bidding war may ensue, with a take-out price in region of 1500-1700p being touted. **Valuation/fundamentals**: A minimum 1150p - 1200p would place BOC on an average rating of a basket of the peer group (The latest speculative run leaves BOC still standing on a discount to the other gases players) and this is more than deserved based on rising return on capital, ambitious capex schedule, cost cutting at Edwards, and generally buoyant trading not least in Asia where BOC has Group operating profit of 41%. **Outlook:** The above positives remain intact, and 2005 prelims (Nov 17, 2005) should highlight generally good trading, the strong balance sheet, capex timetable and further progress at Edwards. Risk /reward therefore suggests that downside from here remains relatively limited, given the likely improvement in the rating based on fundamentals, while speculative interest may well continue for now driving the shares higher in the short term. **Summary**: Speculation seems unlikely to dissipate in the short term, and we would point to BOC's strong balance sheet, capex programme, cost cutting at Edwards and late cycle defensive gases contracts as key attractions to this stock.

Friends Provident 184.5p

On 13th September, AXA purchased 21.5m shares in Friends Provident at an undisclosed price, bringing its shareholding to 15.07%. AXA's fund management unit beneficially owns the shares, even though last week AXA management stated that it was a financial stake rather than a strategic stake and so had "nothing to do with AXA's acquisition strategy. Recommendation: Even if AXA does not make a takeover approach to Friends, because of its relatively small size and distribution network, there is a high probability of someone making a takeover approach at some stage in the same way that Norwich Union, Scottish Provident and Scottish Widows were all taken over following their demutualisations. However, even without any corporate activity, we still rate the shares as **BUY**, price target of **£2** and a dividend yield of **4.2%**.

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Two from Europe…...

BMW €38.14

BMW board of management approved last week a share buy back programme of 20m shares or 3% of shares outstanding. BMW management indicated that the buy back authorisation until November 2006 is for up to 10% of share capital but will be likely to take place gradually over the next 15 months. The significant cash pile (circa €3bln) means that the share buy-back story is likely to be a feature of the BMW story for the medium term. The company is also expected to generate over €1bln in free cash flow over the next 3 years. BMW has under-performed its German peers and the European Auto sector by 10% over the past 8 weeks that is unwarranted given the strong monthly sales figures that BMW is achieving in Europe and the US. Second quarter sales grew 9.3% and most recent deliveries for August rose 23.9%. Our preference for BMW remains focused on (1) the strongest and youngest product pipeline in Europe, (2) Industry leading margins (3) strong ramp up of 3-Series sales over the next two quarters (35% of total group revenues) and (4) undemanding valuation at 10x 2006 earnings. BMW is one of our top picks in the European market. **BUY**

Deutsche Bank AG €76.69

Group profile: Deutsche Bank is a leading international financial services group and the largest bank in Germany. It consists of two operating divisions, Corporate and Investment Banking, which makes up 65% of group profit before tax, and Private Clients and Asset Management. Its major presences are in the German and US markets. Strong Results: The bank recently reported much better than expected results for the 3 months ended 30/06/05. Net profit of EUR947m was significantly ahead of the consensus forecast of EUR803m, and was a year on year increase of 44%. These results confirmed that the bank remains on track to achieve its 2005 pre-tax return on equity target of 25%. Attractive yield: Deutsche also stated that it had accrued EUR700m for dividend payments in H1 2005, resulting in the consensus 2005 and 2006 dividend per share forecasts increasing to EUR2.18 (3.1% yield) and EUR2.50 respectively. This substantial increase in the 2005 dividend indicates that the recent improvements in the bank's businesses are sustainable. Cost savings : The major restructuring program announced in September 2004 included a 9% reduction in total staff numbers. The cost savings from this restructuring program will help drive further earnings growth in 2006. Would note the exceptionally strong earnings reported last week by Goldmans, Lehmans and Bear Stearns**. BUY**

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