Dolmen Daily
DOLMEN STOCKBROKERS
Wednesday Sep 1st 2010

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Anglo claims €25bn is total cost if Nama loans do not fall further *(The Irish Times)*

Eircom issues debt warning as revenues continue to decline *(The Irish Times)*

IL&P defies market predictions and hits "road to recovery" (*Irish Independent)*

INTERNATIONAL PAPERS TODAY

Obama's party face midterm meltdown (*Financial Times)*

Rejection of New Labour cost Brown election, claims Blair (*Financial Times)*

Forex trades hit $4trillion daily *(Wall Street Journal)*

Market View — Analyst: Stephen Taylor

European equity markets have opened slightly stronger this morning following strong finishes in Asia overnight. Data out of Australia and Asia surprised to the upside and is helping to boost markets. Manufacturing data in China grew at its fastest pace since July 2009 with the purchasing manager's index rising to 51.7 from 51.2 in June. GDP data out of Australia also surprised to the upside advancing by 1.2% from the first quarter where it rose by an upwardly revised 0.7%. The resulting figure beat the average consensus for a 0.9% gain. Strong demand from China for commodities is leading to additional capacity being brought on stream by mining companies helping to fuel the economy. In the US consumer confidence data also surprised to the upside. The data should be taken as a clear positive and reinforces our view that the global economy will not enter a double dip recession. That being said we are in a lower growth period and data is likely to remain volatile and be a driver of equity markets. Economic data will be the key theme today. In Ireland live register figures will be closely watched with another set of disappointing results anticipated. Given the widening in the 10-year Irish German spread to 3.57%, markets will be paying close attention to the data. Internationally data out of the US will be the main focus. ADP Employment, Construction Spending and ISM Manufacturing all closely watched.

Kerry: Buy — **Previous Close** €25.92 — **Target** €27.50 — **Analyst** Oliver Gilvarry

We met with Kerry management following the release of its interim results yesterday. The update was positive with the second half of the year looking good. Consumer foods in Ireland has benefited in the first half as cross border shopping has fallen away, along with less UK imports due to GBP strength. The move from branded to private label continues in Ireland as consumers continue to move towards value, but in the UK branded sales remain strong. Conditions remain tough in Ireland consumer foods, but despite this the group managed to increase margins and sales in the division overall. In Ingredients & Flavours, the "Go-to-Market" strategy continues to add value and is continuing to drive performance. In particular the Asia-Pacific Region performed very well with revenue increasing by 11.8% on a life-for-like basis. Management indicated they continue to look at acquisitions in that area. With the group growing its exposure to Asia and Latin America, now 30% of turnover comes from emerging markets. The economic area that continues to show significantly higher growth than in developed economies. We expect the strong performance of the group to continue in the second half of the year. The group is experiencing a currency tailwind for the first time in a number of years and we expect this to continue along with strong turnover and margin performance. We remain buyers of Kerry and see it as the best play in the food sector and an excellent stock for portfolios.

Anglo Irish Bank — **Analyst** Oliver Gilvarry

Anglo Irish Bank released interim results yesterday reporting a loss before tax of €8.2bn for the period. Not surprisingly the reason for the large loss was due to loan impairments and losses on transfers of loans to NAMA which totalled €8.3bn. The group has seen a large fall in net interest income to €352m from €856m in the six month period to end of March 2009. The deposit book continues to decline, falling by 15% to €23.2bn HoH, with a decline of €5.5bn in constant currency terms. Central Bank funding continues to be a large part of the funding of the bank with €26.3bn outstanding at the end of June. Management made comments yesterday on the level of capital required by the bank and are confident that €25bn will be enough. They have submitted a restructuring plan to Europe proposing that 80% of the bank is put into run down with a small viable new bank created from the remainder of the loan book. A decision from the European Commission is expect this month, with a decision on the future of Anglo and the final cost of its bailout required to restore investor confidence in Ireland and lower the cost of financing the national debt.

Integrated Oil

DOLMEN STOCKBROKERS

BP, Chevron and Total provide three contrasting ways to play Big Oil

Analyst: Brian Gallagher

1st September 2010

Introduction

The first half of 2010 was an exceptional period for the oil industry. After a constructive first quarter in which energy prices rose and refining margins recovered, the sector was rocked by the BP disaster in the Gulf of Mexico which resulted in the death of 11 workers and precipitated into the worst oil spill in US history. In this note, we have examined the post Macondo landscape and identified BP, Chevron and Total as the companies that offer the best value.

Current Sector Trends

Energy Prices

When we last reviewed the integrated oil sector in February, we felt that oil would trade in a $70-$90 range during 2010. West Texas Intermediate has averaged just over $80 year to date and currently continues to trade around this fulcrum. We are reiterating our trading range of $70-$90 for the second half as we feel that the global economy will not dip back into recession thereby supporting current demand trends. Nonetheless, we feel that oil's upside will be constrained by the current supply and demand fundamentals. Similarly, we expect gas prices to be muted in the near term as supply from unconventional forms in the US and abroad continues to be ramped up.

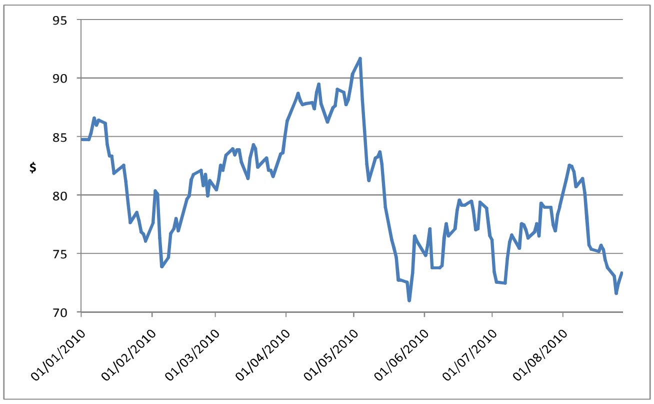
This benign pricing environment is favourable for oil companies as the majority of the majors are cash flow neutral when oil trades in the low to mid 60s. With the commodity trading above this level, as it is now, the industry can finance dividends, initiate share buyback programs and plan capital expenditure with greater certainty. Furthermore, OPEC, which supplies over 30% of the world's oil production, is less likely to intervene in the market with oil at current levels as it views $80 as close to the optimum price. Realisations in second quarter company results were between $73–$78, demonstrating that the sector was able to translate the current prices into earnings.

Supply & Demand

Looking a little closer at the supply and demand dynamics within the oil space, it is difficult to see the commodity breaking out of its current trading range. If anything, oil is likely to be contained to the lower bound of its $70-$90 range in the second half.

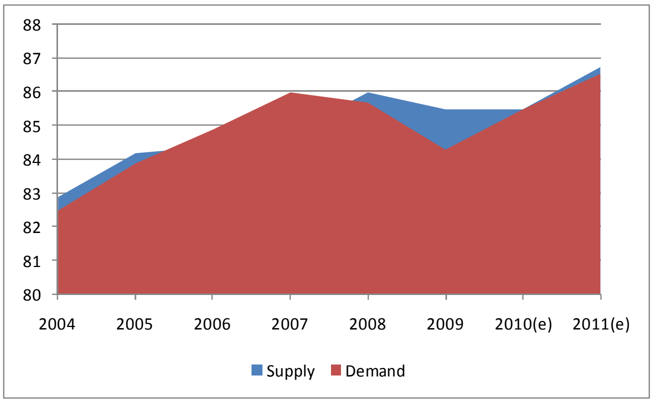
From a supply perspective, evidence suggests that energy markets are not in any danger of deficits over the short to medium term. Since the financial crisis, oil majors have aggressively deleveraged their balance sheets and ramped up production projects that had been mothballed when commodity prices slumped in late 2008 and early 2009. Examples of this increase in production have been prevalent in recent company results and the majority of the majors have outlined plans to increase production over the coming years. State owned oil has also been steadily increasing production having slashed production quotas in an effort to support prices. This has resulted in rising inventories at

Figure 1.1 Crude Oil (West Texas Intermediate)



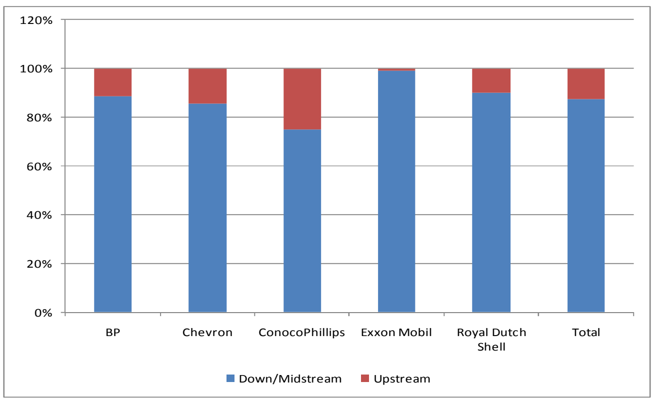
Source: Bloomberg

Figure 1.2 Global Oil Supply & Demand (Mln barrels per day)



Source: OPEC

Figure 1.3 Up/Mid/Downstream Revenue Breakdown



Source: Bloomberg

Current Sector Trends Continued

developed market warehouses. For example, the number of barrels being stored at Cushing Oklahoma, the US's largest oil warehouse, have risen steadily since the second quarter of 2009 to near all time highs today. The current elevated levels are partly due to seasonal effects but the overall picture clearly demonstrates that there is no immediate risk of a supply deficit.

On the demand side, we remain positive despite the current weakening in economic data. We do acknowledge that hopes for a return to robust growth in developed economies has diminished greatly, but we still believe that the US economy will expand by close to 3% this year. Furthermore, global growth continues to be supported by strong activity in emerging markets which is leading to increased demand for energy as developing economies urbanise and industrialise. These trends were supported by the IMF's most recent estimates which place global growth at 4.6% and 4.3% in 2010 and 2011. OPEC paint a similarly optimistic outlook for demand with the oil cartel recently raising its 2010 world consumption estimate by 300,000 barrels of oil per day (bopd) to 85.6 million bopd. Supply and demand is expected to be broadly balanced this year however, from examining data currently coming out of the cartel, we feel that it is likely that a small surplus will occur in 2011. This is primary reason why we believe that the upside in oil prices is limited.

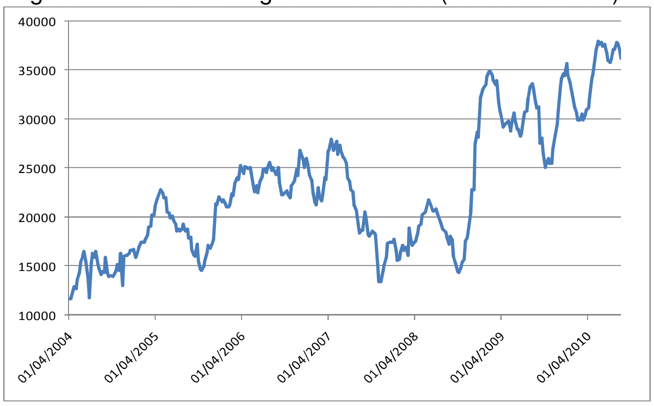
Refining Margins

Industry refining margins remain under pressure with spreads below their historic average (See figure 2.2). This depression in margins is a result of an over capacity in the industry created by over exuberant demand forecasts calculated before the financial crisis. We feel that given the current low utilisation rates, capacity will be forced out resulting in a recovery in margins over the longer term. There has been evidence to support this view with strong improvements seen in refining over the first two quarters of this year. This uptick in refining was also evident in recent corporate results with all over the majors reporting markedly better midstream/downstream earnings. Despite the recent improvement, we do not believe that there has been anywhere near enough capacity removed to call a meaningful turnaround in margins and as a result expect margins to remain below the historic trend.

Macondo Fallout

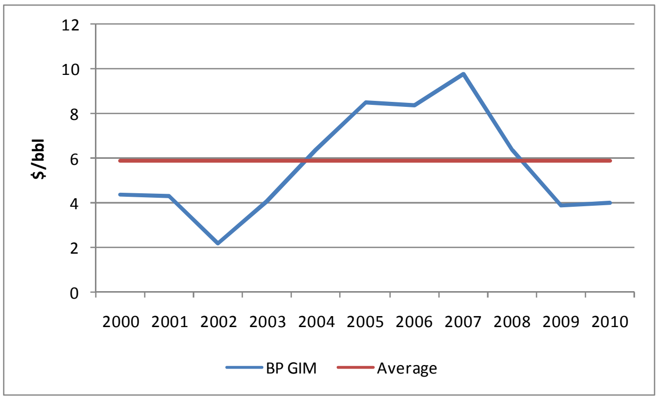
The defining event of the second quarter for the entire industry was BP's disaster in the Gulf of Mexico. The accident has placed a question mark over the safety of deepwater drilling, tarnished what is already poor industry image and will almost certainly result in greater oversight for the sector. Oddly, in the long term we feel that Big Oil will benefit from the regulatory fallout from the disaster. It will increase the barriers to entry and raise fixed costs for all industry participants. We have already seen governments implementing drilling moratoriums while interior departments hastily conduct reviews of the operational practices currently in use. Governments are also considering increasing fines for companies who spill. Both of these initiatives will only have one outcome and that is to increase the cost of exploration and drilling. This favours bigger companies who can leverage larger assets bases and secure cheaper funding in the debt markets.

Figure 2.1 Total Cushing Oil Inventories ('000s of barrels)



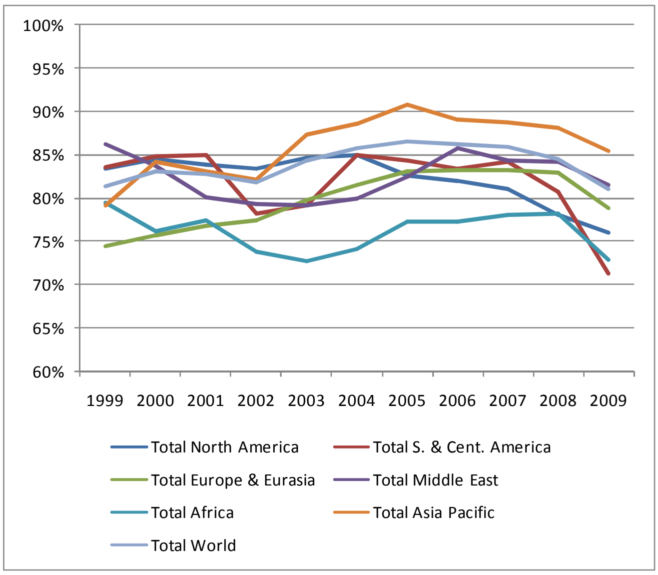
Source: Bloomberg

Figure 2.2 BP Global Refining Indicator Monitor



Source: BP

Figure 2.3 Global Refining Utilisation



Source: BP

Integrated Oil

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Q2 Results Review

Reporting season for the Oil Majors illustrated another quarter of operational progress. Across the sector, management reported significantly improved performances in their chemical and refining businesses, coupled with incremental gains in upstream earnings as higher realisations and increasing year on year production fed through to the bottom line. Probably the most eagerly anticipated results announcement of the entire earnings season was BP's Q2 results. At the event, the company detailed a defence strategy to tackle the aftermath of the Macondo disaster. BP made a $33bn loss provision, named a new CEO and announced an expansive divestment program designed to bolster the company's balance sheet in anticipation of the long legal battle it now faces. BP's FTSE 100 listed peer, Royal Dutch Shell, announced that it had completed its restructuring program ahead of schedule while also reporting that it had taken out more cost than previously guided. Royal Dutch Shell also announced that it was increasing its 2010 divestment from program $4bn to between $8bn and$10bn. In the US, both Exxon and Chevron reported results that included few surprises however, ConocoPhillips stated that it would sell all of its Lukoil stake having previously announced that it would only dispose of half.

The common tone in terms of outlook across the entire sector was one of caution. This reflects an industry that wants to avoid headlines in the second half of the year and one that is not looking to overextend itself as the global economy slowly exits the recent downturn. The increased divestment programs are telling, as oil majors are keen to tidy portfolios rather than aggressively pursue large acquisitions. This trend was evident in the most recent round of the M&A activity with both DANA Petroleum and Cairn Energy receiving bids from companies based in emerging markets while the oil majors have stayed on the sidelines.

Figure 3.1 Industry Metrics

	BP	Chevron	ConocoPhillips	Exxon Mobil	Royal Dutch Shell	Total
Price	380.60	74.08	52.43	59.11	1733.00	36.87
Local Market Cap	£70,954,770,000	$148,944,800,000	$77,772,730,000	$300,976,600,000	£106,292,600,000	€86,502,780,000
$ Market Cap	$109,192,295,553	$148,944,800,000	$77,772,730,000	$300,976,600,000	$163,573,682,140	$109,910,432,268
PE 2010	5.5	8.0	8.5	10.2	8.6	7.8
PE 2011	5.2	7.4	7.2	9.1	7.0	7.2
EV/EBITDA 2010	3.2	3.1	3.6	4.7	4.3	3.7
EV/EBITDA 2011	2.9	2.9	3.5	4.1	3.7	3.4
Reserves MMBOE	18033	11315	10326	22986	13863	10483
Reserves/Market Cap	16.5%	7.6%	13.3%	7.6%	8.5%	9.5%
Div Yield 2010	2.9%	3.8%	4.1%	3.0%	6.2%	6.3%
Div Yield 2011	7.8%	4.0%	4.4%	3.1%	6.4%	6.5%
DEBT/EBITDA	1.0	0.4	1.6	0.3	1.2	1.2
EBITDA/Total 2010	0.17	0.28	0.19	0.29	0.15	0.22
EBITDA/Total 2011	0.20	0.30	0.19	0.33	0.18	0.24
ROE 2010	16.0%	18.8%	14.2%	23.1%	13.5%	19.1%
ROE 2011	18.9%	18.6%	15.0%	25.7%	15.5%	18.6%

Source: Bloomberg and Company Data

Sector Metrics

Following our review of the sector, we believe that three companies offer attractive but differing investment opportunities. BP is an unique play that provides the most upside from a capital perspective. While many question marks still remain over the company's future, we believe that the market is excessively discounting for this uncertainty and that BP's financial position and asset base is robust enough to deal with the fallout from Macondo. Barring BP, Chevron is the most attractive from a valuation perspective and the company's ability to deliver above average earnings per barrel differentiates the company from its peers. Finally, Total is our chosen yield play. The European based refiner's valuation metrics compare favourably with its peers and it is best positioned to take advantage of the strengthening dollar.

Figure 3.1 displays some of the metrics under which we have assessed the industry. From a purely valuation perspective BP is clearly attractive. It is the cheapest stock on PE and EV/EBITDA multiples and has the highest percentage of the reserves to market cap. Currently the stock is not paying dividends on account of the Gulf of Mexico disaster but we expect the company to reinitiate its distribution policy at the company's Q4 results in late January of 2010.

Chevron offers low gearing, competitive PE and EV/EBITDA multiples and a high yield for a US based equity. Figure 4.2 on the following page highlights one of the major reasons why we rate Chevron a buy. The company delivers the second highest earnings per barrel of production behind Exxon which trades on a significantly higher valuation multiples. This characteristic allows the Chevron to generate superior profitability from a comparatively smaller production base.

Our preferred yield play also offers material scope for capital appreciation. Total trades below average multiples and produces the third highest earnings per barrel behind Exxon Mobil and Chevron. The stock's dividend yield is superior to peers and the company's earnings will benefit from the continued weakness of the euro.

Finally, we feel that Royal Dutch Shell and Conoco Phillips do not differentiate themselves from their peer group on a valuation basis. Exxon Mobil does offer impressive ROE and earnings per barrel but this is clearly reflected in the company's valuation.

Integrated Oil

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Investment Strategies

BP (Previous Close) - 380p (Price Target) - 510p

We acknowledge that BP will face significant political, legal, strategic and regulatory challenges over the coming years however we feel that the market is discounting excessively when accounting these issues. It is our view that the post Macondo BP offers significant value as the company's asset disposal strategy will give the oil major more than enough protection from the repercussions of the accident while also realising value in its portfolio. In addition, the company remains operationally strong with this was illustrated at the company's recent results when it reported clean earnings $5bn. From a balance sheet perspective, we see manageable risk from Macondo. Gearing at Q2 was 21% and it could move to as low as 9% after BP completes its asset disposal programme. The company's net debt at Q2 was $34bn, it has $16bn in undrawn debt facilities, the suspended dividend has freed up another $7.75bn and it recently secured another $5bn in loans against future revenue. Finally, we believe that BP will reinstate its dividend in early 2011 thereby reopening the stock to income funds who were forced out due to prospectus obligations. We are setting our 12 month price target at 510p which equates to BP trading at 7x its 2011 earnings. This multiple is a material discount to BP's historic average.

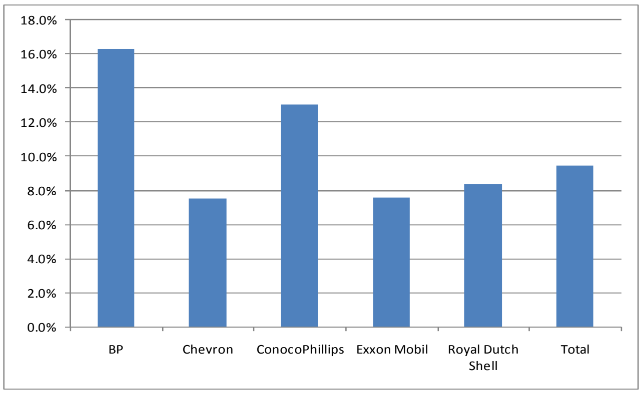
Chevron (Previous Close) - $74.08 (Price Target) - $90

As detailed in the previous section, Chevron compares favourably to peers on valuation metrics and commands the second highest margin per barrel in the sector. In addition to this, Chevron is the second smallest refiner of the supermajors (see Figure 1.3) and therefore it has a low exposure to what is expected to be a weak refining market over the coming years. Furthermore, a significant number of the refineries it does operate have an advantageous geographical position in that they're located close to growing Asian markets. The group's production is also expected to expand significantly over the next two years as major projects in West Africa, Brazil and the Gulf of Mexico are brought online providing organic production growth. After these projects are ramped up Chevron's focus will turn to the Gorgon LNG field off the coast of Australia. This asset is expected to start producing in the second half of the decade and again is ideally located to service growing Asian markets. We are setting our 12 month price target at $90 which equates to Chevron trading at 9x its 2011 earnings.

Total (Previous Close) - €36.87 (Price Target) - €45

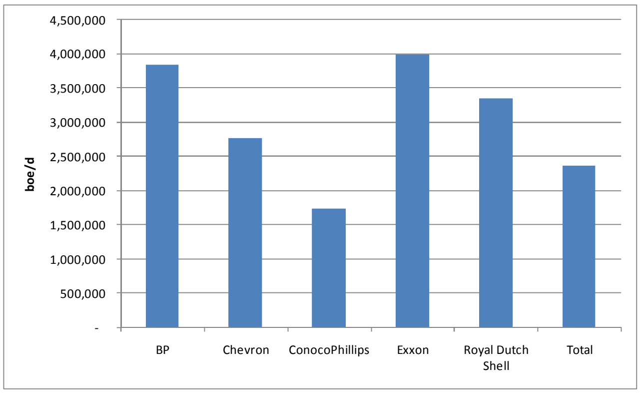
We feel that the market is underestimating the stability and earnings potential of our chosen dividend play in the sector. For instance, although Total is highly exposed to what is a weak European refining market, it is still produced net income in excess of $3.75bn in the second quarter. This clearly illustrates the profitability of the business despite the challenging earnings environment. Furthermore, given how weak refining has been in Europe we expect any recovery in margins to be skewed towards the upside with this skew further accentuated by expected capacity take out. Lastly, the fact Total reports in euro but trades largely in dollars meaning that it will benefit from the continued weakness in the euro. We are setting are 12 month price target price target at €45 which equates to Total trading at 9x 2011earnings.

Figure 4.1 Reserves to Market Cap



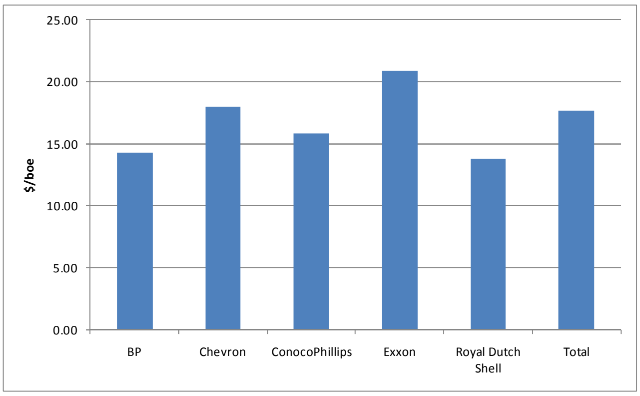
Source: Bloomberg and Company Data

Figure 4.2 Q2 Production



Source: Company Data

Figure 4.3 Earnings per Barrel



Source: Company Data

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Market Movers

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International Equity Markets

Index	Value	1-Day	YTD
ISEQ	2,704	1.3%	-9.4%
FTSE	5,225	0.5%	-3.3%
Dow Jones	10,015	-1.4%	-4.0%
S&P	1,049	-1.5%	-5.9%
Nikkei	8,824	-3.6%	-15.4%
Stoxx 50	2,623	0.2%	-11.6%

Sector Performances

Sector	Index	1-Day	YTD
Construction	232	0.2%	-16.1%
Technology	182	-0.6%	-1.6%
Oil & Gas	288	-0.4%	-13.1%
Financials	210	0.1%	-5.5%
Retail	264	-0.1%	8.3%
Food & Drink	335	0.4%	10.5%

Commodity Prices

Commodity	Index	1-Day	YTD
Crude Oil	71.92	-3.7%	-13.7%
Copper	337.00	-1.7%	1.3%
Gold	1,247.45	0.8%	13.9%
Silver	19.43	1.9%	14.4%
Wheat	685.75	-2.7%	14.8%
Cattle	97.28	-0.8%	8.2%

Currency Exchange Rates

Currency	Index	1-Day	YTD
€/$	1.268	0.1%	-11.3%
€/£	0.826	0.9%	-6.9%
£/$	1.535	-0.7%	-4.9%
$/JPY	84.200	-0.5%	10.5%
€/JPY	106.760	-0.4%	-19.7%
€/SFR	1.287	-0.9%	14.9%

5Yr Credit Spreads

Product	Index	1-Day	YTD
Invest Grade	119.7	-0.9%	61.5%
High Yield	513.3	1.0%	7.7%
Financials	143.6	-1.1%	98.3%
BoI	325.2	3.1%	51.2%
AIB	438.8	5.0%	72.6%
RBS	201.6	2.0%	36.5%

Money Market Rates

Rate	EUR	UK	US
Overnight	0.4%	0.5%	0.2%
3-Month	0.9%	0.7%	0.3%
1-Year	1.1%	1.1%	0.4%
2-Year	1.2%	1.2%	0.7%
5-Year	1.7%	2.0%	1.6%
10-Year	0.023	2.9%	2.5%

Date	Company	Region	Event
01/09/2010	Trintech Group PLC (IRE)	IE	Q2
01/09/2010	Gartmore Irish Growth Fund	GB	AGM
01/09/2010	H.J. Heinz Co.	US	Q1
02/09/2010	Pernod Ricard SA	FR	FINAL
02/09/2010	DSG International Plc	GB	TRADE
02/09/2010	Hays PLC	GB	PRELIM
02/09/2010	H&R Block	US	Q1
03/09/2010	British Airways PLC	GB	TRAFFIC
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Date	Event	Region	Estimate
01/09/2010	PMI Manufacturing	GE	- -
01/09/2010	PMI Manufacturing	EC	- -
01/09/2010	PMI Manufacturing	UK	- -
01/09/2010	MBA Mortgage Applications	US	- -
01/09/2010	ADP Employment Change	US	- -
01/09/2010	ISM Manufacturing	US	- -
01/09/2010	ISM Prices Paid	US	- -
01/09/2010	Construction Spending MoM	US	- -
02/09/2010	PMI Construction	UK	- -
02/09/2010	Euro-Zone PPI (MoM)	EC	- -
02/09/2010	Euro-Zone GDP s.a. (QoQ)	EC	- -
02/09/2010	ECB Interest Rates	EC	- -
02/09/2010	Nonfarm Productivity	US	- -
02/09/2010	Unit Labor Costs	US	- -
02/09/2010	Initial Jobless Claims	US	- -
02/09/2010	Continuing Claims	US	- -
02/09/2010	Factory Orders	US	- -
02/09/2010	Pending Home Sales YoY	US	- -
03/09/2010	PMI Composite	EC	- -
03/09/2010	PMI Services	UK	- -
03/09/2010	Euro-Zone Retail Sales	EC	- -
03/09/2010	Change in Private Payrolls	US	- -

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Regulatory Information

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