

## DAVY MORNING EQUITY BRIEFING

08 September 2010

### MARKET COMMENT

**Consumer confidence edges back in August as Irish 10-year bond yields drift to 6%** The KBC/ESRI consumer sentiment index registered a fall in August, to 61.4 from 66.2 in July. Taking a three-month average in order to derive a stronger signal, the index fell to 65.2 from 66.5 in the three months to end-July. While the level is still consistent with a recovery in consumption and the wider economy, the fall comes on top of recent similar movements in indicators such as retail sales, the trade surplus and the Live Register, adding weight to the perceived moderation in the pace of recovery.

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### RESULTS AND EVENTS

**Wednesday September 8th;** Grafton - ex-dividend - interim dividend rate - 2.5c. Glanbia - ex-dividend - interim dividend rate - 3.03c. Diageo - ex-dividend - final dividend rate - 23.5p. CPL Resources FY results. Barratt Developments FY results. **Thursday September 9th;** Consumer price index, Aug. Redrow FY results. **Friday September 10th;** Industrial production and turnover, Jul. **Monday September 13th;** Associated British Foods - trading statement. **Tuesday September 14th;** Petroceltic interim results. **Wednesday September 15th;** UTV Media - ex-dividend - interim dividend rate - 1.0p. Fyffes - ex-dividend - interim dividend rate - 0.55c. Ryanair Holdings - ex-dividend - special cash - 34.0c. **Wednesday September 22nd;** Origin Enterprises FY results. Ryanair Holdings - AGM - Radisson Hotel, Dublin Airport, Co. Dublin - 10.00.

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**MARKET COMMENT****Consumer confidence edges back in August as Irish 10-year bond yields drift to 6%****Aidan Corcoran**

The KBC/ESRI consumer sentiment index registered a fall in August, to 61.4 from 66.2 in July. Taking a three-month average in order to derive a stronger signal, the index fell to 65.2 from 66.5 in the three months to end-July. While the level is still consistent with a recovery in consumption and the wider economy, the fall comes on top of recent similar movements in indicators such as retail sales, the trade surplus and the Live Register, adding weight to the perceived moderation in the pace of recovery.

The fall in Irish consumer confidence comes against the backdrop of rising sentiment elsewhere: the American Conference Board consumer confidence index beat forecasts to post a three-point gain, rising to 53.5 in August from 51.0 in July, while the European Commission's economic sentiment indicator for the EU rose to 102.7, up 0.6. The fact that the Irish consumer bucked this trend suggests that domestic woes are behind the move, with the €25bn — give or take a few billion — Anglo bill a likely candidate.

Spreads on Irish bonds widened again, showing that investors are as concerned as consumers at the prospect of rising sovereign debt. Yields rose to over 6%, the highest in more than a year, before retreating to 5.98% at yesterday's close. Exchequer returns for August, showing an on-target consolidation of the underlying fiscal position, have done little to soothe fears but will help to ease spreads over the medium term.

**CONSTRUCTION AND BUILDING MATERIALS****Highway construction falls 22% in July as state and local budgets decline; confirms CRH's more cautious outlook; latest stimulus proposal seen as largely political****Barry Dixon**

**FACTS:** Latest data from ARTBA indicate that the value of highway construction projects put in place fell by 22% in July compared to the same month last year. This brings the year-to-date decline to 10.7%. The most likely explanation is that state and local government highway budgets have been significantly reduced and only partly offset by ARRA funding.

Meanwhile, our contacts in Washington are of the view that the announcement by President Obama of a new infrastructure stimulus programme was largely politically motivated. In a conference call, the under secretary at the transportation department indicated that the proposal would be unlikely to go before Congress ahead of the mid-term elections in November.

**ANALYSIS:** The latest ARTBA data appear to confirm the more negative outlook issued recently by CRH. The decline is all the more concerning in light of the fact that this was expected to be the peak year of ARRA expenditure. The scale of the decline in state and local budgets must therefore be significant.

While it is broadly accepted by industry bodies that the proposed \$50bn in infrastructure stimulus is in addition to the regular \$42bn of federal funds spent under the Federal Highway Programme, there is little belief that the proposal will have any impact short term. What is interesting however is that all parties agree on the principle of increased spending on infrastructure — the point of discord is how the spending will be funded. Until there is a clearer — and acceptable — view on this, further developments are likely to be limited.

**DAVY VIEW:** The sharp decline in infrastructure put in place in July is a concern for those players involved in the sector. It is all the more worrying for the overall industry when combined with continuing weakness in the residential and non-residential construction markets. CRH has already warned that its profits will be lower in the second half and its share price has suffered accordingly. However, its main heavy-side US peers, including Vulcan Materials and Martin Marietta, continue to trade on relatively high multiples. It will be interesting to see if these valuation levels can be maintained in light of the deteriorating newsflow.

**Sector valuations****Barratt Developments plc (BDEV LN)**

Price: 104p      Rating: Outperform      Issued: 30/06/09

**FY results comfortably ahead; outlook predictably cautious****Robert Gardiner**

**FACTS:** Barratt Developments has reported (September 8th) results for the year ended June 2010. The group reported operating profits of €90.1m versus the Davy estimate of £85.1m (consensus: £82.3m). FY sales were £2.035bn versus our estimate of £2.03bn (consensus: £2.02bn).

**ANALYSIS:** The FY operating margin was stronger at 4.4% (Davy: 4.2%), implying a H2 margin of 5.9%. The improvement in margin was driven by a combination of house price growth and further cost reductions. Total completions in the period were 11,377 homes (-14.2% year-on-year) at an average selling price of £174,300 (+10.9% yoy). The average sales price was 17.8% higher in the second half of the year, primarily due to mix changes. Private selling prices increased by 11.2% to £185,200, again primarily due to mix changes.

Net debt at year-end was £366.9m and has been reduced by £543.1m in the period by a combination of the rights issue, placing and cash generation. Tangible net assets at year-end were 208p. At September 5th, forward sales had increased to £847.1m (+21.7% yoy), while in the ten weeks since year-end the reservation rate had fallen to 0.48 per active site per week (from 0.52 in H2). The group has now agreed terms on £527.2m of land purchases. Exceptional costs in the period were £129.9m and reflected payments in relation to the group's financing arrangements, restructuring costs and impairments on a property development.

The outlook is predictably cautious, with the lack of availability of mortgage finance and the broader economic environment creating uncertainty. Since spring, sales have trended back to seasonally low levels; however, sales rates are still in line with management's targets. The group is targeting total completions for the new financial year up 5-10% and expects to see mix-related price increases.

**DAVY VIEW:** The results are comfortably ahead of both the Davy and consensus estimates. Management is clearly delivering in terms of the operational performance of the business and de-leveraging the balance sheet. Tangible net assets of 208p at year-end are double the current price of 104p — a discount which is overdone in our view. However, a negative top-down view of the UK is driving sentiment towards the sector and is unlikely to reverse in the short term.

#### Company summary and analysis

### Berkeley Group (BKG LN)

Price: 838p      Rating: Neutral      Issued: 30/06/09

#### Issues trading statement

##### Robert Gardiner

**FACTS:** Berkeley Group has issued (September 8th) an interim management statement covering the period from May 1st to August 31st.

**ANALYSIS:** Demand for properties in the period has remained resilient, particularly in London, driven by a shortage of supply and demand from international purchasers. Outside London, a lack of credit availability and overall consumer confidence is preventing an increase in transaction volumes at this point. In line with the group's strategy, an additional 23 sales outlets have been opened in the period while eight new sites have been acquired. Net cash remains in excess of £300m. Not surprisingly, the new government's move to decentralised planning has created a degree of uncertainty in the planning process. Combined with changed design requirements for new homes, this will likely result in a lower level of new homes unless the planning burden is reduced. Despite the challenging market conditions, the group has increased the value of its land-bank, held forward sales above £600m and maintained its target of growing EPS by 10% in the current financial year.

**DAVY VIEW:** While flagging weak trading conditions outside London, the group remains committed to land spend and continued to make acquisitions in the period. Importantly, it is maintaining its FY guidance despite the challenging market conditions.

#### Company summary and analysis

### Outlook for US non-residential remains weak based on evidence from NCI Building Systems

#### Flor O'Donoghue

**FACTS:** US components and engineered building systems business, NCI Building Systems, has reported fiscal Q3 results to August 1st.

**ANALYSIS:** NCI (market capitalisation c.\$175m) is a proxy for private non-residential activity in the US. Given this context, it is no surprise that the business has been struggling. This is evident in the stock's performance, which was over \$330 in May 2006 and is now \$9, having reached \$15 earlier this year. In its Q3, revenues actually rose (+3% to \$245m) but gross margins fell over 500bps, the most plausible reason being the impact of rising steel prices. NCI lost \$16.5m after-tax in the quarter, bringing its year-to-date loss after tax to over \$292m. The group's shareholders' equity at August 1st had shrunk to just \$7.1m (there was also \$248m in cumulative convertible participating preferred stock). The near-term trading outlook remains poor: NCI refers to 'the well-reported economic pullback that affected July bookings [which] has limited our visibility'. According to NCI, its end-quarter backlog was down 14%.

**DAVY VIEW:** NCI's results and prospects indicate that the near-term prospects for private non-residential activity in the US remain weak. Among those exposed to this market are Kingspan and Wolseley. In Kingspan's case, the group is operating in a niche market and attempting to gain market share off a very low level. In Wolseley's case, however, much of its pivotal Ferguson business is dependent on the overall direction of non-residential activity in the US. It is estimated that US non-residential construction accounts for almost 25% of group revenues.

#### Sector valuations

## Cement prices starting to rise in southern India

Barry Dixon

**FACTS:** Our sources in India are indicating that cement prices in the southern region increased by Rp20-40/bag (c.10%) over the past couple of weeks, reversing the fall in recent months. Prices across the rest of India have stabilised, apart from the west where prices have declined by a further Rp10/bag.

**ANALYSIS:** The rise in southern prices is surprising given the large capacity overhang, slower demand relating to the ongoing monsoon and a highly fragmented, and therefore competitive, market.

**DAVY VIEW:** The latest price movement may signal an end to the declines experienced in recent weeks as a result of slower demand and excess capacity. India remains one of the most attractive cement markets globally with double-digit demand growth likely to continue for a number of years. Better pricing is positive for Holcim which is the number-two cement producer in India and also for CRH which has operations in Andhra Pradesh in southern India.

Sector valuations

## FINANCIALS

### Extension of guarantee to allow banks to focus on term funding effort

Stephen Lyons

**FACTS:** The Minister for Finance yesterday (September 7th) announced that the government guarantee for short-term bank liabilities, including corporate and inter-bank deposits as well as debt securities, would be extended from its current expiry date of September 29th to December 31st 2010.

**ANALYSIS:** According to the statement, the extension is an important support to the Irish banking system, facilitating banks' access to both shorter- and longer-term funding to help maintain the overall stability of the sector. An approval by the European Commission under state aid rules needs to be secured before the guarantee can be extended.

On June 28th, the commission approved the extension of the issuance window under the ELG Scheme from September 29th to December 31st 2010 for liabilities of between three months and five years duration, except inter-bank deposits, and retail deposits regardless of maturity up to a fixed term of five years. This announcement adds the remaining liabilities under the ELG scheme to the extension, being short-term liabilities (0-3 months) including corporate and inter-bank deposits, so that now all liabilities under the scheme benefit from the full extension of the issuance window to December 31st 2010.

**DAVY VIEW:** In our note issued yesterday ('Funding squeeze is manageable as sector restructuring enters crucial phase'), we argued that the expiry of the guarantee in Q4 for short-term corporate and inter-bank deposits needed to be carefully monitored as it could lead to an outflow of corporate deposits. The announced extension is therefore positive and will allow the Irish banks to pursue their efforts to term out wholesale funding this year, without adding to the magnitude of this effort.

The fact that Irish banks are still reliant on a government guarantee for funding is not a positive in itself, but we note in the statement that about 16 other countries in Europe also still have a guarantee in place. In the history of banking crises, it is also the norm rather than the exception that guarantees are extended beyond their original expiry date, as guarantees are set for expiry closer than is possibly practicable in order to compel banks to ready themselves for funding on an unguaranteed basis.

Sector valuations

### Bank of Ireland (BKIR ID)

Price: 72c      Rating: Neutral      Issued: 07/09/10      Previous: Outperform      Issued: 30/06/09

### Exchange offer for LT2 debt offers modest capital generation

Stephen Lyons

**FACTS:** BKIR yesterday (September 7th) announced an exchange offer for its outstanding C\$400m of fixed/floating dated lower tier-2 (LT2) instruments due September 2015, for equivalent fixed/floating dated instruments due September 2018. The purpose of the exchange offer is to enhance the capital base of the bank and the exchange ratio is 81.25%.

**ANALYSIS:** The announced exchange offer from BKIR is not very significant for core capital generation. By way of illustration, if we assume the full take-up of the C\$400m of instruments, the transaction would only yield an up-front capital benefit of €56m. The floating rate on the existing instruments is currently 75bps over the three-month Canadian inter-bank rate versus a fixed coupon of 8.5% on the new instruments. Ignoring swaps, this corresponds to an additional interest bill of €15m per annum.

**DAVY VIEW:** Despite proposed touted changes in Basel's treatment towards LT2 instruments, they are likely to remain an important debt instrument for the bank. Given that BKIR maintains a bank holding company in the US, it needs to maintain a total capital ratio in excess of 10%. If we look out over the next few years, a key capital event is the eventual buyback of outstanding government preference shares (€1.9bn), which would reduce total capital. Swapping these LT2 instruments not only adds a modest capital gain now but also creates a more liquid instrument with hopefully a more developed secondary market, which should facilitate future issuance and support the total capital ratio.

Company summary and analysis

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**RECRUITMENT**
**CPL Resources (CPL ID)**

Price:240c Rating:Outperform Issued:30/06/09

**Ends financial year in strong cash position; turns the corner on profit growth****Joshua Goldman****FACTS:** CPL Resources has released (September 8th) full-year results for the year ended June 30th, 2010.**ANALYSIS:** For the 2010 financial year, CPL had a pre-tax profit of €5.3m (Davy: €5.0m) as compared to €1.7m in the 2009 financial year (after an impairment charge of €8.1m). Gross profits decreased by 19% as compared to the previous financial year. However, examining the half-yearly breakdown, gross profits were 18% higher in H2 of financial year 2010 than in H1 and 5% higher than H2 of financial year 2009.

The group generated €4.2m from operating activities and spent €1.8m on acquisitions. It ended the period with a strong cash balance of €43.5m. This strong performance resulted in the board recommending a final dividend of 2.5c per share. This will bring the total dividend for the year to 4.0c per share. If approved by shareholders, the dividend will be payable on November 26th to shareholders on the company's register at the close of business on the record date of November 19th.

**DAVY VIEW:** Although the environment remains difficult, CPL has managed not only to continue paying a dividend but also to increase its cash balance. One of the keys to its success was the reduction of the cost base by €2.6m. As demonstrated by the half-yearly breakdown of gross profits, the environment is improving and we expect this to translate into an even better performance next financial year.

CPL is already laying the groundwork for this by increasing its number of consultants from 194 at the start of the year to 222 at the year-end. It is also growing its international brand by opening an office in Hungary and a second one in Poland. As a by-product of growing its international presence, the group clearly becomes less dependent on a single country's economy, which should work to its advantage.

Looking towards next year, we expect margins to improve as the economic environment gets better. The time to place each candidate will decrease as the number of positions available increases. We also expect the company to see benefits from its acquisitions. We remain very positive on CPL and reiterate our 'outperform' rating.

**Company summary and analysis**


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**PHARMA AND HEALTHCARE**
**United Drug (UDG ID)**

Price:229c Rating:Outperform Issued:30/06/09

**Re-financing through new banking facility and US dollar private placement****Jack Gorman****FACTS:** UDG has announced, as anticipated, the re-financing of its bank and other funding facilities.**ANALYSIS:** The company's new financing structure is broadly similar to that which obtained prior to this. A \$130m private placement has been completed in seven and ten-year tranches (\$65m each), replacing the \$102m of notes currently in issue. We understand that the new notes carry interest rates of up to c.4.5%. UDG's existing bi-lateral bank facilities have also been reorganised into a four-bank syndicate, for a €135m facility with a duration of four years.**DAVY VIEW:** Some of UDG's banking facilities, and the first tranche of its original private placement, were to mature next year, so the re-financing is not surprising. It allows the company to extend out its debt maturities and provides access, via private placement, to additional cash for investment purposes.

We understand that the incremental private placement notes and higher rates mean that blended interest costs will rise by approximately €4m. However, this will be offset partly by the contribution from the recent InforMed acquisition and over time, from acquisition activity delivering a return in excess of the cost of funds. We will review our 2011 forecasts, but at first glance there may be some modest (c.3%) downside to PBT. UDG will report FY results on November 17th.

**Company summary and analysis****AGI Therapeutics (USc) (AGI ID)**

Price:\$0.04 Rating:Neutral Issued:14/04/10

**Interim results****Jack Gorman****FACTS:** Interim results (September 8th) show that AGI recorded a loss of \$3.1m, including intangible impairment charges, in the first half of 2010.**ANALYSIS:** Net cash reserves at the end of June 2010 stood at \$10.4m, down \$1.6m from six months earlier. This comprised a \$1.05m operating cash outflow and a \$0.55m effect from FX changes (AGI retained some of its cash in euros). Our projected FY cash burn of \$5.3m looks too high given this outturn.

Several R&D updates were also provided in the statement. Management has concluded that further development of Rezular in chronic diarrhoea is not justified, balancing the scientific merit of the approach with the regulatory costs and burden associated with its further development. Exploration of Rezular's utility in a non-GI indication, namely pulmonary arterial hypertension (PAH), requires further pre-clinical work which will take some time to complete (partners may be sought to advance this). A separate, undisclosed product candidate has been identified and is undergoing feasibility assessment; AGI expects to meet with the FDA in the next quarter to help make a final determination on its potential. Licensing activity of potential new candidates is also ongoing.

**DAVY VIEW:** AGI's cash and modest running costs allow for R&D investment in 2010/11 to rebuild its pipeline. When there is more visibility on the pipeline, it will be possible to establish a more accurate valuation beyond cash value. Cash value stands at approximately 12c per share, based on the June 2010 reserves.

#### Company summary and analysis

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## RESOURCES AND ENVIRONMENT

### Dana Petroleum Plc (DNX LN)

Price: 1808p      Rating: Neutral      Issued: 15/07/10

### **Buys more North Sea assets from Petro Canada**

#### Job Langbroek

**FACTS:** Dana has announced (September 8th) the acquisition of 33.5m proven and probable barrels from Petro Canada UK Limited for £240m. The purchase adds another eight fields to Dana's portfolio and will bring its exit production to c.70,000 barrels of oil per day by the end of the year. The assets acquired include £60m of capital allowances.

**ANALYSIS:** The deal follows the purchase of a similar amount of reserves and resources, also from Suncor, located in the Dutch sector of the North Sea in June this year. The purchase price of just over \$11 per proven and probable barrel is reasonable, especially in light of location and attached tax allowances. It also matures the group's production profile with politically acceptable reserves and resources. In short, it is exactly the kind of package that might be attractive to KNOC in its quest to secure oil reserves and production. The purchase is predominately oil-based and according to guidance, will be earnings accretive almost immediately. The deal will be financed through debt available under the group's new \$900m facility in addition to a \$300m extension. Interestingly, there are pre-emption rights over one-third of the current assets being purchased.

**DAVY VIEW:** The deal was undoubtedly made with the defence of the KNOC bid in mind. The argument will be that KNOC should pay for the additional value created. Dana will point to the report by an independent expert which values the purchased proven and probable assets at £368m, £128m (or 140p per Dana share) above the price paid by Dana. The deal is well pitched in that it gives KNOC an opportunity to increase its offer without being seen to change its mind on its former 'not a penny more' position. However, we suspect that the Dana acquisition will complete either way.

#### Company summary and analysis

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## THE DAY IN NUMBERS

	<i>Index value</i>	<i>Change</i>	<i>% Change</i>
<b>IRISH MARKET</b>			
Total Market (ISEQ)	2782.6	-24.5	-0.9
ISE Financials Index	763.0	-44.0	-5.5
ISE General Index	3502.6	-12.2	-0.4
ISE Small Cap Index	1664.5	3.2	0.2
<b>SECTOR INDICES</b>			
FTSE E300 Constr. & Mats.	1287.8	-7.9	-0.6
FTSE E300 Food Producers	1550.9	2.3	0.2
FTSE E300 Travel & Leisure	1150.0	1.6	0.1
<b>EUROPEAN MARKETS</b>			
FTSE Eurofirst 300	1061.8	-4.0	-0.4
FTSE 100	5407.8	-31.4	-0.6
CAC 40	3643.8	-40.9	-1.1
DAX	6117.9	-37.2	-0.6
<b>US MARKETS</b>			
S&P 500	1091.8	-12.7	-1.2
Nasdaq	2208.9	-24.9	-1.1
DJIA	10340.7	-107.2	-1.0
<b>REST OF THE WORLD</b>			
ASX All Ordinaries	4613.0	-2.7	-0.1
FTSE/JSE Africa All Share	27665.3	-315.3	-1.1
NZ All Ordinaries	740.1	7.2	1.0
Hang Seng	21095.9	-305.9	-1.4
Shanghai SE Composite	2698.4	2.1	0.1
Nikkei 225	9018.1	-207.9	-2.3
<b>COMMODITIES</b>			
Brent Oil US\$/bbl	76.6	0.5	0.6
CRB Commodity Index	463.0	1.7	0.4
Gasoline US\$/gal	188.8	-3.1	-1.6
Gold \$/t oz	1256.6	6.9	0.6
Natural Gas GBp/therm	40.3	0.3	0.6
<b>EXCHANGE RATES</b>			
Stg/EUR	0.8259	-0.0102	-1.2
USD/EUR	1.2681	-0.0193	-1.5
USD/Stg	1.5352	-0.0043	-0.3
<b>INTEREST RATES</b>			
Euro 3 Mth Money Rate	0.88	-0.00	-0.1
UK 3 Mth Money Rate	0.73	0.00	0.2
US 3 Mth Money Rate	0.29	-0.00	-0.1
<b>BOND YIELDS</b>			
Ireland 10 Yr Bond Yield	5.78	0.21	3.8
Euro 10 Yr Bond Yield	2.25	-0.09	-3.9
UK 10 Yr Bond Yield	2.91	-0.07	-2.5
US 10 Yr Bond Yield	2.59	-0.11	-4.0

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**Neutral:** Performs in-line with the relevant E300 sector (+/-10%) over the next 12 months.

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		Percent	Count	Percent
Outperform	57	67	29	78
Neutral	22	26	8	21
Underperform	5	5	0	0
Under Review	0	0	0	0
Suspended	0	0	0	0
Restricted	0	0	0	0

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