Irish Equity Morning Note

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Disclosures begin on page 12

August 24, 2010

Market Update

Index	Cur Level	% Change 1D	5D	1M	YTD
S&P 500 INDEX	1067.4	-0.4	-1.1	-3.2	-4.3
NASDAQ COMPOSITE INDEX	2159.6	-0.9	-1.0	-4.8	-4.8
FTSEUROFIRST 300 INDEX	1036.5	0.7	-0.9	-0.7	-0.9
FTSE 100 INDEX	5234.8	0.8	-0.8	-1.5	-3.3
NIKKEI 225	8993.0	-1.4	-1.8	-4.6	-14.7
SHANGHAI A SHARES	2921.8	0.9	-0.7	4.6	-18.3
IRISH OVERALL INDEX	**2780.9**	**0.9**	**-1.2**	**-4.7**	**-6.5**

Forex	Latest	1d%	6m%
Euro/$	1.2647	-0.2	-6.6
Euro/Stg	0.8199	-0.5	7.2
Euro/Yen	107.38	0.4	13.7
$/Yen	84.92	0.4	6.1

Bond Yields	Latest	1d bp	6m bp
US 10yr	2.58	-2.0	-111.3
German 10yr	2.28	0.0	-84.8
UK 10yr	2.97	-0.5	-110.5
Japanese 10yr	0.93	-1.1	-29.6
Irish 10yr	5.34	3.3	70.4
Irish/German 10yr Spread	3.05	3.02	1.50

Corporate Bond Yields	Latest	1d%	6m%
Moody's AAA Indices	4.36	0.0	-19.7
Moody's BAA Indices	5.52	0.2	-14.2

US Corporate Bond Spreads (over US 10yr Treasury)	Latest	1d%	6m%
Moody's AAA Indices	1.78	3.0	-93.7
Moody's BAA Indices	2.94	2.1	-90.0

Official CB Interest Rates	Latest	1d%	6m%
ECB Rate	1.000	0.0	0.0
UK Base Rate	0.500	0.0	0.0
US Fed Funds	0.250	0.0	0.0
JPY Rate	0.100	0.0	0.0

Money Market Rates	Latest	1d%	6m%
Euribor EUR 3M	0.891	0.1	34.8
Libor GBP 3M	0.721	-0.4	12.2
Libor USD 3M	0.318	-3.6	26.0

Money Market Spreads (over Official CB Rates)	Latest	1d%	6m%
Euribor EUR 3M Spread	-0.109	0.9	-67.8
Libor GBP 3M Spread	0.221	1.3	54.7
Libor USD 3M Spread	0.068	17.4	3379.4

Commodities	Latest	1d%	6m%
WTI Crude Future	72.7	-0.4	-11.4
Gold	1221	-0.4	11.5
CRB US Spot Foodstuff	388	-0.5	11.7
CRB US Spot Metals	809	-0.8	1.7
Baltic Dry Index	2841	3.1	4.3

- US markets continue to creep lower, with the S&P future at its lowest level in a month (1062.20). The dollar is also strengthening against the euro, reaching its strongest level since mid-July (1.2648), while 10 year yields in Germany (2.24%) and the US (2.57%) continue to signal that inflation is not a concern in those economies in the medium-term.

- The latest round of US labour market data, trade data and manufacturing surveys (Philly Fed, Empire) have been extremely discouraging and signal an economy that is slowing quickly. US GDP is expected to have fallen from a pace of 5.0% saar in Q4 2009 to just 1.4% in Q2 2010.

- In contrast, German GDP was this morning confirmed to have grown by 2.2% q/q in Q2 2010. Domestic demand grew by 1.4% y/y with consumption up 0.6% and capital investment up 4.7%. Exports grew by an impressive 8.2% while imports grew by 7.0%.

- German exports have been boosted by robust Asian growth, the Asian Development Bank has upped its growth forecast for the region from 7.5% to 7.9% in 2010 on a better than expected first half performance. Growth is expected to slow in the second half of the year and the revision is simply a mark-to-market exercise to reflect past dat. Nonetheless the key point is that these economies have gathered momentum.

- This is reflected in many of the regions stock indices with the Indian NIFTY continuing to post new recovery highs and reaching its highest level since January 2008 (12% off its all time high); the Thai and Malaysian indexes are just 3% below their all time highs; the Indonesian index is at its all time high; and the Korean KOSPI is just below its recovery high.

- Based on historical data, the prospects for the S&P 500 are not particularly promising either. Using Robert Shiller's historical S&P data and price to 10 year earnings we split the historical observations into quintiles from low p/10e to high p/10e. When the p/10e ratio is in the lower quintile the average 1 year nominal (real) return is 13.45% (9.16%); the second quintile returns average 8.63% (5.84%); third quintile returns average 3.48% (3.0%); fourth quintile returns average 2.31% (0.16%); and finally the top quintile sees returns average 1.5% (-1.05%). The current S&P p/10e ratio is at the upper end of the fourth quintile at 20.6. So while the US economy is clearly slowing, the prospects for the US stock market are not particularly promising and the outlook for the pace of the global economic recovery is highly uncertain it's not quite time to throw the towel in yet without careful monitoring of Asia.

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CRH	€14.03	BUY	Construction & Materials

Key financials (EUR)	12/09	12/10e	12/11e
Sales (m)	17,373	17,157	17,793
EBITDA (m)	1,803	1,912	2,166
EBITDA margin	*10.4%*	*11.1%*	*12.2%*
EBIT (m)	981	1,088	1,350
EBIT margin	*5.6%*	*6.3%*	*7.6%*
Net Profit (adj.)(m)	592	702	925
ROCE	4.8%	5.3%	6.7%
Net debt/(cash) (m)	3,723	3,765	3,250
Net Debt/Equity	*0.4*	*0.4*	*0.3*
Debt/EBITDA	2.1	2.0	1.5
Int. cover(EBITDA/Fin. int	6.1	7.8	9.4
EV/Sales	1.0	0.8	0.7
EV/EBITDA	9.2	7.1	6.1
EV/EBITDA (adj.)	9.2	7.1	6.1
EV/EBIT	16.9	12.6	9.7
P/E (adj.)	21.5	14.0	10.6
P/BV	1.2	1.0	0.9
OpFCF yield	*16.6%*	*15.4%*	*17.1%*
Dividend yield	*4.5%*	*4.5%*	*4.7%*
EPS (adj.)	0.88	1.00	1.32
BVPS	15.39	14.47	15.16
DPS	0.63	0.63	0.66

- **Significant EPS cuts following weak performance in America Materials**
- CRH expect full-year 2010 EBITDA to decline 10% from the 2009 level of €1.9bn. This equates to an EBITDA of €1.6bn, 15% below our expectations. In its interim trading update on July 7 CRH said it expected EBITDA in the second half of the year would be ahead of last year (new guidance implies a 5% decline in second half EBITDA). As a result we will be cutting our 2010 EPS to approximately 70c (from 100c). Our EPS for 2011 of 130c will also be cut following the management meeting this morning.
- The weakness stems from the Americas Materials business which has experienced weaker than expected volumes and more competitive pricing due to lower than anticipated levels of commercial construction and pull-backs in state and municipally funded projects. Overall second half USD profitability in Americas Materials will be lower than last year compared with CRH's previous estimate of an improved second half outturn.
- Second quarter results were inline with the July trading update with EBITDA of €520m, declining 20% year-on-year and sales declining 8% to €7.7bn.
- America: In the US, Material sales on a constant currency basis declined by 11%. Overall like for like volumes in aggregates, asphalt and readymixed declined by 8%, 9% and 11% respectively. The Group achieved a modest price increase in aggregates but experienced declining pricing in other components. Liquid Asphalt prices were 12% higher year on year offset by a 10% decrease in the Group's energy costs. In America Products the rate of decline continued to improve as the first half progressed. H1 sales declined by 12% with Q2 sales declining by 4%. A strong performance in the APG business was offset by continued weakness in the MMI and Glass divisions.
- Europe: In Europe total sales and EBITDA declined by 7.5% and 16.6% respectively. In Materials trading conditions remained resilient in Switzerland, Finland and Poland. Pricing remains competitive given the decline in volumes. In Products sales declined by 10% in H1 with the rate of decline easing in Q2 to only -3%. Trading conditions remain particularly weak in Netherlands and Denmark offset by a strong performance by the UK clay business. In Distribution sales declined by 6.7% reflecting weakness in the residential sector.
- **Net Debt**: Net debt declined to €4.8bn at the end of the first half, versus €5.1bn in June 2010, inline with the July trading update. This was as a result of a higher first-half working capital outflow and an adverse €0.5bn translation impact on debt. **Acquisitions**: In the first half CRH completed 14 acquisitions mainly across its European and America Materials division at a total cost of €159m. Since the end of the first half the Group has made six additional transactions at a total cost of €86m. The Group acquired a 75% stake in a leading Belgian merchant SHAP business with nine branches across the East and West Flanders region. The Group continues to maintain a patient approach in progressing transactions in light of the challenging market backdrop.
- **Cost Savings**: CRH remains on track to achieve further cost savings of €365m in FY2010, binging cumulative cost savings to €1.7bn since 2007. The total cost to implement these savings is expected to reach €325m with €298m spent to date. **Dividend:** The interim dividend of 18.5c was maintained. We forecast a full-year dividend of 62.5c, in line with 2009, but given the weak outlook this may be under review.
- Overall we will be cutting our forecasts significantly follow today's update from CRH. We expect 2010 EPS of approximately 70c (from 100c). Our EPS for 2011 of 130c will also be cut following the management meeting this morning. Our rating is under review pending a meeting with CRH later this morning.

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Kingspan	€5.37	HOLD	Construction & Materials

Key financials (EUR)	12/09	12/10e	12/11e
Sales (m)	1,126	1,164	1,231
EBITDA (m)	103	103	116
EBITDA margin	*9.1%*	*8.8%*	*9.5%*
EBIT (m)	63	63	76
EBIT margin	*5.6%*	*5.4%*	*6.2%*
Net Profit (adj.)(m)	48	42	56
ROCE	6.5%	6.6%	7.9%
Net debt/(cash) (m)	164	121	88
Net Debt/Equity	*0.3*	*0.2*	*0.1*
Debt/EBITDA	1.6	1.2	0.8
Int. cover(EBITDA/Fin. int	17.1	8.2	12.9
EV/Sales	1.0	0.9	0.8
EV/EBITDA	11.3	9.8	8.4
EV/EBITDA (adj.)	11.3	9.8	8.4
EV/EBIT	18.5	16.1	12.8
P/E (adj.)	20.9	21.4	16.0
P/BV	1.7	1.5	1.4
OpFCF yield	*18.8%*	*8.1%*	*8.5%*
Dividend yield	*0.0%*	*1.9%*	*2.2%*
EPS (adj.)	0.29	0.25	0.34
BVPS	3.50	3.64	3.87
DPS	0.00	0.10	0.12

- **Cutting 2011 EPS on margin outlook. Maintain Hold rating**
- Following Kingspan's interim results we are increasing our 2010 EPS to 25.1c (from 24.1c) but decreasing our 2011 EPS forecast to 33.5c (from 37.9c). We forecast sales of €1.2bn in 2011, a 5.7% increase year-on-year. We maintain our Hold recommendation.
- Although first half results were relatively strong with operating profit of €33.1m 9% ahead of last year and 22% ahead of our forecasts management's comments on the outlook for margins were relatively cautious. As a result we have cut our operating margin assumption for 2011 to 6.2% (versus our previous forecast of 7.5%). We expect operating margin in 2010 of 5.4% (in line with previous forecasts).
- Kingspan expect access floors margin to be 4/5% next year, versus 15.1% generated in the first half of 2010. The margin recovery we had anticipated in panels and insulation in 2011 will not be as high as forecast as a result of rising raw material costs offsetting the benefits of operating leverage.
- For the full-year 2010 we expect Kingspan to pay a dividend of 10c (4c interim dividend declared).
- We expect net debt to decline to €121m at the end of 2010, from €164m at the end of 2009. This equates to net debt/EBITDA of 1.2x and leaves Kingspan well placed to make further acquisitions. The acquisition of AIR-CELL, acquired in Australia towards the end of 2009 continues to perform strongly.
- Overall we maintain our Hold rating. Kingspan is trading on a 2011 EV/EBITDA of 8.6x, versus SIG on 6.3x and Rockwool on 6.3x. While conditions are slowly improving, the outlook for access floors coupled with the lag effect of passing on raw material price increases will impact margins in the second half and into 2011.

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Aer Lingus	€0.93	Ireland/Airlines

- **Aer Lingus reports strong improvement in H1**
- Aer Lingus this morning reported an improved pre-exceptional operating loss of €19m, versus a loss of €93m last year and in-line with our forecast of a loss of €19m.
- The better first half performance reflects higher yields and lower fuel and staff costs. The company has maintained its earlier guidance that operating profit in 2010 will be no worse than break even – this does, however, assume no further disruption from industrial action or airspace closures. Gross cash increased by €181m since year-end to €1,010m; this is partly offset by higher debt which rose by €116m driven by aircraft payments. As management revealed in July, short-haul yields and long-haul yields rose by 9.0% and 17.5% in H1 (and by 13.8% and 20.9% in Q2).
- Overall capacity cuts of 16% and 20% in H1 and Q2 respectively have contributed to the strong rise in ticket prices, although higher transfer traffic and occupancy levels in long-haul business class are also encouraging. Volcanic disruption costs of €10m and lost contribution of €10m are as previously guided. Fuel costs will increase next year – Aer Lingus has 37% of its FY11 fuel requirements hedged at €783 versus 82% at €726 this year.

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Irish Life & Permanent	€1.51	BUY	Ireland/Banks

Key financials (EUR)	12/09	12/10e	12/11e
Total Revenue (m)	469	471	500
Pre-Provision Profit (PPP)	182	216	245
Operating profit (OP)	*-194*	*-174*	*-95*
Earnings Before Tax (m)	-319	-156	-77
Net Profit (adj.) (m)	*-182*	*-114*	*-48*
Shareholders Equity (m)	2,471	2,356	2,309
Tangible BV (m)	2,346	2,231	2,184
RWA (m)	20,185	20,185	20,185
ROE (adj.)	*-6.9%*	*-4.7%*	*-2.0%*
Tier1 Ratio	9.2%	9.1%	8.8%
Cost/Income	61.2%	54.1%	50.9%
P/PPP	5.0	1.9	1.7
P/E (adj.)	nm	nm	nm
P/BV	0.4	0.2	0.2
P/NAV	0.4	0.2	0.2
Dividend Yield	0.0%	0.0%	0.0%
PPPPS	0.66	0.78	0.88
EPS (adj.)	*-0.66*	*-0.41*	*-0.17*
BVPS	*8.94*	*8.47*	*8.24*
NAVPS	8.94	8.47	8.24
DPS	0.00	0.00	0.00

Interim results due Tuesday, 31 August

- IL&P is set to release interim June 2010 results next Tuesday (31 August). We forecast an operating loss per share of 26c, principally reflecting margin erosion in the banking business coupled with elevated loan loss provisioning (H1 2009: loss 16c).

- Banking business: We expect IL&P to generate half-year pre-provision losses of €10m (H1 2009: profit: €57m). Income levels are set to be significantly impacted by the cost of the ELG scheme, which we estimate at €60m for the six months. Inclusive of this, we forecast net interest income to decline 44% (y-o-y) to €109m, with margins falling to 50bps (H1 2009: 87bps).

- Excluding ELG costs, we expect the underlying margin to reduce 9bps (y-o-y) to 78bps, as high wholesale funding costs and liability spreads continue to take their toll (below full-year guidance of 80bps to 85bps). Additional government guarantee costs of €15m (CIFS scheme) are also anticipated, while other income is set to remain broadly flat (y-o-y) at €24m. We forecast cost reduction of 10% (y-o-y) in the period to €130m.

- IL&P's May IMS highlighted how signs of stabilisation were beginning to appear in the formation of early Irish mortgage arrears. However, with property prices still falling and unemployment rising, we see further downside risks. Our forecast assumes an impairment charge of €177m (92bps of average loans) at the half year stage, but the timing in recognition of provisioning may differ over the cycle (we still forecast aggregate writedowns of €1.1bn over the three years to 2011, above management guidance of €800m - €900m). Overall we expect half-year 2010 banking losses of €187m (H1 2009; loss €132m). Given the precarious funding situation, any improvement to the loan to deposit ratio will be welcomed (2009: 246%). On a related note, media reports this morning suggest that IL&P has issued €250m of two year bonds through its fastnet securitisation programme. Importantly, this deal was conducted without government assistance and is an important step for the group on its road to recovery (no pricing details were disclosed).

- Life Business: On new business sales, we expect retail to decline a further 5% (y-o-y) at the half-year to €65m, with corporate declining by 20% (y-o-y) to €73m. The improving trend in ILIM is forecast to continue, with sales increasing 20% (y-o-y) to €72m. Margins are also expected to rise by 90bps to 10.3% (Life – 12%, ILIM – 7%) as cost reductions begin to take effect. Overall new business contribution is set to remain broadly stable (y-o-y) at €23m.

- We forecast interim earnings from the in-force book to rise 4% (y-o-y) to €63m (H1 2009: 61m). IL&P has previously flagged that persistency assumption changes made in 2009 should be sufficient to cover any lapses in 2010, so reaffirmation of this is likely to appease potential concerns at the interim stage. Overall, our HY 2010 Life contribution is set to increase 2% (y-o-y) to €86m. Below the line, aggregate negative short term investment fluctuations and economic assumptions of €20m are forecasted, primarily reflecting the turbulent market conditions experienced in May/June relating to the sovereign debt crises.

- Elsewhere, an update in relation to the Regulator's PCAR estimate for the group will also be of key interest, with management guiding towards a total equity raise of €0.9bn to recap the bank last May. Overall, the significant pressures currently being experienced in IL&P's banking business are likely to take centre stage at the group's results next Tuesday. Largely as a result of increased guarantee costs, the bank's pre-provision result is forecast to slip into negativity territory on our numbers for the first time. We believe that full-year consensus estimates for the banking business are likely to come down following the interims, with potential ramifications for the quantum of equity needed to recap the bank on demerger. As such we take a cautious stance on the stock and highlight the risk of further share-price weakness over the near-term.

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Kerry Group	€24.55	BUY	Ireland/Food & Beverage

Key financials (EUR)	12/09	12/10e	12/11e
Sales (m)	4,521	4,740	4,868
EBITDA (m)	520	571	604
EBITDA margin	*11.5%*	*12.0%*	*12.4%*
EBIT (m)	406	454	487
EBIT margin	*9.0%*	*9.6%*	*10.0%*
Net Profit (adj.)(m)	291	329	364
ROCE	10.6%	12.2%	12.8%
Net debt/(cash) (m)	1,160	999	773
Net Debt/Equity	*0.9*	*0.6*	*0.4*
Debt/EBITDA	2.2	1.7	1.3
Int. cover(EBITDA/Fin. int	7.4	7.9	9.7
EV/Sales	1.1	1.1	1.0
EV/EBITDA	9.2	9.3	8.4
EV/EBITDA (adj.)	9.2	9.3	8.4
EV/EBIT	11.7	11.7	10.4
P/E (adj.)	12.4	13.1	11.8
P/BV	2.8	2.8	2.3
OpFCF yield	*14.7%*	*10.5%*	*11.3%*
Dividend yield	*1.0%*	*1.1%*	*1.2%*
EPS (adj.)	1.66	1.88	2.08
BVPS	7.34	8.83	10.51
DPS	0.25	0.28	0.30

- **Strong H1 positions Kerry to deliver despite rising input costs**

- Kerry reports H1 results on August 31st. Based on its May IMS, we expect H1 revenues to increase by approximately 6% to €2.4 billion. We expect Kerry to report margin expansion of circa 50bps to 8.5% (+70bps in ingredients and +40bps in consumer foods) suggesting Group EBIT of €204m. After interest and tax, this yields a H1 EPS estimate of circa 76c – growth of 13% on H1 2009 (67.2c).

- Kerry's May IMS noted that underlying like for like growth at Group level was 1% with volumes ahead strongly (+5.1%) offsetting lower pricing, negative FX and rationalisation volume eliminations. Ingredient volumes were +5.2% while consumer food volumes were +3.3% despite a very challenging retail environment in Ireland. The May update mirrored performance updates from key peers and customers of Kerry. Recent Q2 updates from peers and customers underpin the May guidance. On a regional basis, we expect double digit growth in Asia, with the US outpacing the slower European growth. Key positives for Kerry include more favourable FX translation rates of overseas earnings and continued recovery in consumer food branded volumes. However, the fly on the ointment is the spike in some key input prices. Kerry is a major purchaser of agri inputs including cereals, dairy, sugar, vegetable oils and cocoa. Following the 2008 spike in agri input costs, Kerry reconfigured its strategy to deal with agri input price volatility and quickly recovered its margins. Consequently, we see the current spike in some agri commodity prices as only a modest risk to forecasts. Kerry relies heavily on acquisition for growth. The Group has avoided acquiring at peak cycle multiples opting instead to pay down debt, to fund organic growth expansion and to seek on smaller bolt-on acquisitions (Newmarket co-op €33m bid). This strategy has transformed Kerry into a leaner manufacturing cost base and reduced debt levels. With net debt forecast to fall to 1.8x by year end, Kerry remains in a strong position to fund acquisitions from existing resources.

- We expect Kerry's H1 statement to reflect strong double digit EPS growth on the comparable period. However, given the additional challenge of higher prices for some key inputs (wheat) we expect little change to our full year forecasts for Kerry at this stage while recognising that Kerry is well placed to preserve and enhance its margins despite the input price volatility. Kerry remains on track to report full year double digit earnings growth and is well placed to accelerate growth via acquisition as debt declines due to its impressive cash generation.

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Diageo	GBp 1082.0	BUY	United Kingdom/Food & Beverage

Key financials (GBP)	06/09	06/10e	06/11e
Sales (m)	9,311	9,875	10,070
EBITDA (m)	3,059	3,337	3,180
EBITDA margin	*32.9%*	*33.8%*	*31.6%*
EBIT (m)	2,613	2,861	2,904
EBIT margin	*28.1%*	*29.0%*	*28.8%*
Net Profit (adj.)(m)	1,621	1,763	1,912
ROCE	23.9%	27.9%	27.7%
Net debt/(cash) (m)	7,661	6,000	5,130
Net Debt/Equity	*1.9*	*1.2*	*0.9*
Debt/EBITDA	2.5	1.8	1.6
Int. cover(EBITDA/Fin. int	5.2	7.5	6.9
EV/Sales	2.9	3.0	2.9
EV/EBITDA	8.7	8.9	9.3
EV/EBITDA (adj.)	8.7	8.9	9.3
EV/EBIT	10.2	10.4	10.2
P/E (adj.)	13.4	15.0	14.1
P/BV	6.7	6.5	5.4
OpFCF yield	*11.4%*	*13.2%*	*10.6%*
Dividend yield	*3.2%*	*3.4%*	*3.5%*
EPS (adj.)	65.23	70.52	76.48
BVPS	129.62	162.84	200.94
DPS	35.01	36.55	38.37

- **Normality returning but FX volatility remains a drag factor**
- Diageo reports full year results on August 26th. The year under review will reflect a weak H1 (reflecting significant destocking in scotch – the key category for Diageo) with H2 recovering especially into Q4. Net organic sales growth recovered from -2% in H1 to +2% for the nine month period reflecting strong Q3 organic growth of +12% (against weak comparables). Recent updates from peers suggest the improving sales growth trend continues.
- We expect margin to benefit from cost reductions / synergies and lower financial charges offsetting weak H1 performance. Margins have benefited significantly from the decline in AMP rates.
- Diageo has consistently reiterated guidance for low single digit organic profit growth for FY10 which coupled with the lower financial costs yoy and favourable FX should see the group report eps growth of 8%+. Our EPS estimate is 70.5p, based on sales of £9.8bn and EBIT of £2.86bn. We expect dividend growth of 5%.
- We see little risk of Diageo disappointing in FY10 earnings given its market updates, its dominance in the sector and the improving pace of recovery in premium spirits consumption in H2. Forecasts are underpinned by good progress on cost reductions and synergy harvesting. The benefit of having the strongest balance sheet in the sector adds considerable comfort to the outturn.
- The key focus of the result will be outlook and guidance. While recent updates from competitors in the premium spirits sector point to continuing recovery, especially in Asia, Diageo faces a year of less favourable FX translation and transactional FX rates. We expect to see AMP investment increase in line with economic recovery in mature markets such as the US and Europe. However, to offset the increase AMP investment and protect margins we expect Diageo to seek upward price increases in FY11 as recovery strengthens. But this may not be possible in all markets. Emerging market performance in Russia and Latam look set to sustain strong growth and recovery. Africa is likely to remain a bright spot for Diageo, as its leverages the Guinness brand into more markets and adds new capacity. However, FY10 market share gains by Guinness in ROI and the UK in the LAD category is likely to face increased competition from re-emerging growth in beer and continued growth in cider consumption.
- We expect no surprises in terms of FY10 outturn with the key focus being outlook and guidance. We expect Diageo to signal a return to price increases (maybe not in all markets) to offset a likely increase in AMP investment. Its growth strategy in Asia will remain important given the strength of Asian economic growth relative to Diageo's more mature European and North American markets. We see little risk to our BUY recommendation given Diageo's leadership in the premium spirits sector, its balance sheet strength to fund bolt-on acquisitions and support dividend growth. The Group has implemented significant re-organisation cost saving measures to boost margins during the downturn which should support performance in FY11. While FX yoy is less favourable, Diageo's FX management tends to be well planned to de-risk transactional exposures.

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Irish Continental Group	€15.00	BUY	Ireland/Transportation

Key financials (EUR)	12/09	12/10e	12/11e
Sales (m)	261	273	282
EBITDA (m)	51	55	63
EBITDA margin	*19.5%*	*20.0%*	*22.2%*
EBIT (m)	27	30	37
EBIT margin	*10.2%*	*10.8%*	*13.2%*
Net Profit (adj.)(m)	25	26	35
ROCE	13.2%	14.7%	20.4%
Net debt/(cash) (m)	22	5	(18)
Net Debt/Equity	*0.1*	*0.0*	*-0.1*
Debt/EBITDA	0.4	0.1	-0.3
Int. cover(EBITDA/Fin. int	31.8	30.3	62.6
EV/Sales	1.5	1.4	1.3
EV/EBITDA	7.5	6.9	5.7
EV/EBITDA (adj.)	7.5	6.9	5.7
EV/EBIT	14.3	12.8	9.6
P/E (adj.)	13.5	13.6	10.4
P/BV	2.4	2.4	2.3
OpFCF yield	*15.9%*	*13.7%*	*15.6%*
Dividend yield	*6.7%*	*6.7%*	*6.7%*
EPS (adj.)	1.08	1.10	1.45
BVPS	6.19	6.19	6.57
DPS	1.00	1.00	1.00

Strong Tourism, Stabilising Freight Expected

- Irish Continental reports interims to 30 June on 27 August. The **first half is seasonally less important** for the Group (37% of 2009 EBITDA) but we expect it to show: A **solid performance in the tourism market**, where volumes grew from mid-2009 and will have been boosted by the ash cloud impact on air travel during the period. In its 13 May IMS Irish Continental reported that car carryings were down by 3.7% on the Irish Sea first 4 months of the year, though better yields offset lower volumes. An **improving trend in roll-on roll-ff freight volumes**, though with an overall decline for the period still likely. In May the Group outlined a 4% fall in ro-ro volumes in April, though volumes for the 4 months were still 15% lower. The Group noted that overcapacity, notably on the long-sea routes, continued to impact rates. **Resumed volume growth in the Group's container operations (+10.5% in 4 months) and in its Dublin and Belfast terminals (+5.6% in 4 months)**, though with container rates also held back by capacity in the lo-lo market. **Cash generation will remain a standout feature**, with net debt expected to be circa €30m, *after* paying €25m in dividends on 18 June. We forecast net debt of €5m by year end.

- **Outlook** - the Group has *not* previously provided an outlook for the period but our 110 cent forecast EPS in 2010, modestly up on the 107 cent earned in 2009 (despite higher fuel costs) is expected to be attainable, based on 2010 EBITDA of €54.5m. We expect further modest volume growth in 2010 and into 2011, with an estimated **80% of incremental revenues falling to the Group's bottom-line earnings**. This drives our currently forecast 145 cent in 2011 and 177 cent in 2012, both of which **assume no economic "double-dip"** and both of which reflect the **Group's circa 60% exposure to economies outside of Ireland**.

- **Trading** - the **update on current trading should be positive** in terms of tourism – ash cloud related uncertainty drove bookings in late spring and early summer, while the recovery in Sterling against the euro will have boosted the attractions of Ireland as a destination for holidaymakers originating in the UK, the Group's main market. The comment on freight is likely to underline that overcapacity is continuing to impact rates and that Irish Continental will not chase marginal or unprofitable business. Last week's update from **DFDS outlined the continued challenges on the Irish Sea** and identified improvement as a key focus. Any **capacity rationalisation would be positive for all players in the sector**. Fuel costs will show a marked increase for the year, having risen by €4.1m in the first 4 months.

- **Dividends** - we **expect the Group to revert to the payment of an interim dividend**, a change from the full year distributions made in recent years. Given the seasonality of earnings, a split of 25/75 or 30/70 is likely in our view. Irish Continental has returned 100 cent to shareholders in each of the past three years and we expect this level of payout to be at least maintained. With negligible net debt forecast at December 2010 and modest (sub €10m pa) annual capital expenditure commitments, this **sustainable dividend yield of 7%+, backed by a free cash flow yield of 12%, underpins the attractions of the stock**.

- **Pride of Bilbao** - We **do *not* expect an update on the MV Pride of Bilbao**, which comes off charter in October 2010. The Group continues to assess the options of sale, re-charter or operation of the vessel. A sale would be likely to realise well in excess of book value. We do not have any concerns over this charter uncertainty and, in the event that the ship is tied up idle post October, its impact is a modest 1% per month on earnings. The likely surplus over book value that a sale would realise is testament to the conservative carrying value of the Group's vessels. We have **previously estimated upside of 50%+ to book values**.

- **Overall** - In summary, interims are of limited importance and should again highlight the strong cash generation of the business. Economic uncertainties persist but sea remains the only feasible means to transport 99%+ of all imports and exports. In tourism, airline capacity cuts totalling an estimated 25% on Ireland-UK, coupled with ever-increasing

add-on charges, are boosting volumes. **With a yield of 7%+ investors in Irish Continental are being paid to wait for economic recovery, safe in the knowledge that this payout is secure. When recovery does materialise, it will drop to the bottom line. We maintain our BUY stance and €20 per share price target.**

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Independent News & Media	€0.66	BUY	Ireland/Media

Key financials (EUR)	12/09	12/10e	12/11e
Sales (m)	1,256	1,304	1,328
EBITDA (m)	217	245	275
EBITDA margin	*17.3%*	*18.8%*	*20.7%*
EBIT (m)	177	205	236
EBIT margin	*14.1%*	*15.7%*	*17.8%*
Net Profit (adj.)(m)	92	47	71
ROCE	9.9%	11.4%	0.0%
Net debt/(cash) (m)	1,044	938	843
Net Debt/Equity	*1.9*	*1.6*	*1.3*
Debt/EBITDA	4.8	3.8	3.1
Int. cover(EBITDA/Fin. int	3.0	2.9	3.6
EV/Sales	1.2	1.3	1.2
EV/EBITDA	7.2	6.9	5.8
EV/EBITDA (adj.)	7.2	6.9	5.8
EV/EBIT	8.8	8.2	6.7
P/E (adj.)	nm	7.0	4.6
P/BV	nm	nm	4.5
OpFCF yield	*63.3%*	*61.7%*	*80.7%*
Dividend yield	*0.0%*	*0.0%*	*0.0%*
EPS (adj.)	0.00	0.09	0.14
BVPS	(0.21)	0.00	0.15
DPS	0.00	0.00	0.00

- ## Interim results to show a return to growth
- On 27th August, Independent News & Media (INM) is due to report results for the six months to June this year that we expect will show revenue growth for the first time in two years. The combination of operating leverage, cost-cutting initiatives in 2009, and the disposal of loss-making assets support our EBIT forecast of €91m (+25% yoy) and EBITDA of €111m (+22% yoy). Further, deleveraging in H1 should leave the Group well-placed to achieve its net debt/EBITDA target of 3.0x in FY 2011.
- Driven by early evidence of recovery in Australasia and South Africa, in addition to FX benefits, we expect INM to report a return to reported sales growth during H1 this year. Our revenue expectation of €650m (+6.8% yoy) for the first six months of the year reflects Australasian revenues of €330m (+26% yoy) and South African revenues of €105m (+2.8% yoy). The disposal of the UK assets, the impact of 2009's cost-cutting initiatives, and operating leverage are behind our anticipated step-up in EBITDA for H1. Our estimate of adjusted PBT is €51m (+32% yoy), from €38m in H1 2009. Our adjusted EPS estimate for H1 is 2.9c.
- **From stabilisation to revenue growth**: In the first six months of this year we believe that INM has built upon the evidence of stabilisation in H2 2009, when the rate of revenue contraction for the year to December 2009 slowed to 13.2% yoy on a constant currency basis, compared with a decline of 14.9% yoy at the interim stage. Expected revenue growth of 26% in Australasia and 2.8% in South Africa during H1 reflects improving trading and the impact of currency benefits.
- **Evidence of positive operating leverage**: The fixed nature of INM's cost base implies that signs of positive operating leverage should be seen in upcoming results. In contrast to the negative operating leverage seen in the recent downturn, we expect a recovery in the EBITDA margin to c. 17% in H1 compared with 15% in H1 2009. Similarly, we expect the EBIT margin to rise to c. 14% from 12% a year ago.
- **Cash flow & deleveraging**: Our near-term growth outlook provides scope for INM to progressively reduce Group indebtedness. A marginal improvement in cash generation and/or further asset disposal will see INM achieve its medium term net debt/EBITDA target of 3.0x in FY 2011. The disposal of INM's remaining 5.7% stake in JPL, announced on 4th August, will contribute to the Group lowering net debt/EBITDA to less than 4.0x by the financial year end. For H1 we forecast net debt in the region of €1bn, a mild improvement from the €1,044m reported at the end of FY 2009.
- **Risks to the investment case:** Any deviation from the anticipated economic developments in INM's markets is the main risk to its earnings recovery. Value destructive disposals are less of a risk in our view given management's leverage target, which we believe is broadly achievable on our current estimates.
- Ahead of the release of interim results we maintain our Buy rating on INM and adjust our target price to €1.16, to reflect the current market value of APN News & Media. Highlighting the market's low rating of INM, at the current share price the stock commands PE and EV/EBIDA multiples of 7.0x and 6.9x for this year, offering discounts to its Australian and ESN peer groups.

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Europe Yesterday

24-Aug-2010

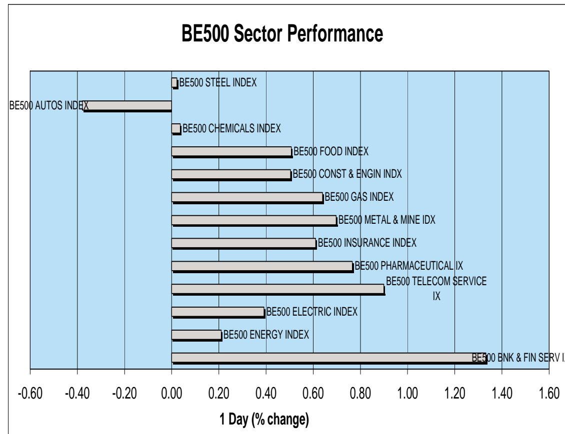
Europe Performance Indicators

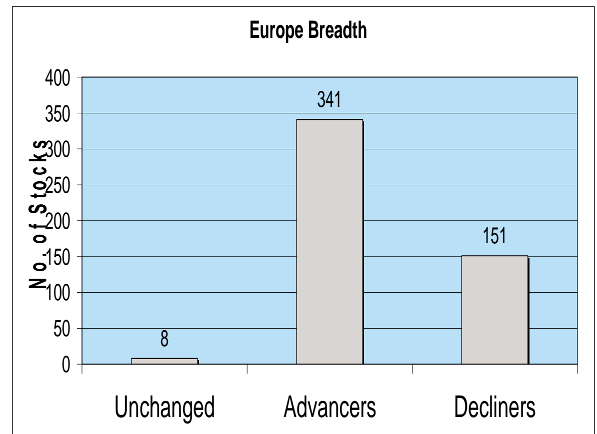
	Direction	Value	Performance % 1 Day	3 Mth	YTD
BE500	↑	178.37	0.68	6.96	0.37
Index Volume as % of 3 mth avg		51%			

European Sector Performance

Europe Breath

A / D Ratio	2.26





Individual Stock Perfomance

Best performers Short_Name	Country	Sector	Price	% Change 1 Day	** % Avg Daily Volume
NATIXIS	FR	Diversified Banking Inst	4.33	5.30	76
ITV PLC	GB	Television	56.65	3.94	59
AVIVA PLC	GB	Life/Health Insurance	391.20	3.57	77
PETROFAC LTD	GB	Oil-Field Services	1410.00	3.52	137
EADS NV	NE	Aerospace/Defense-Equip	18.53	3.52	94
BANCA POP EMILIA	IT	Commer Banks Non-US	8.95	3.35	87
OLD MUTUAL PLC	GB	Life/Health Insurance	124.90	3.22	128
SBM OFFSHORE NV	NE	Oil-Field Services	12.18	3.05	128
BANCA CARIGE	IT	Mortgage Banks	1.67	3.02	82
SAINSBURY PLC	GB	Food-Retail	366.50	3.01	111

Worst performers Short_Name	Country	Sector	Price	% Change 1 Day	** % Avg Daily Volume
AMLIN PLC	GB	Property/Casualty Ins	408.20	-3.25	154
BOSKALIS WES	NE	Building&Construct-Misc	29.58	-3.02	146
VOLVO AB-B	SW	0	82.80	-2.82	117
AGGREKO PLC	GB	Commercial Services	1467.00	-2.72	66
DSM (KONIN)	NE	Chemicals-Diversified	34.01	-2.48	127
EURASIAN NATURAL	GB	Metal-Diversified	849.00	-2.25	94
PUBLIC POWER COR	GR	Electric-Integrated	12.62	-2.17	17
LINDE AG	GE	Industrial Gases	89.49	-2.14	99
HELLENIC PETRO	GR	Oil Refining&Marketing	5.96	-1.97	17
SMA SOLAR TECHNO	GE	Power Conv/Supply Equip	84.86	-1.88	90

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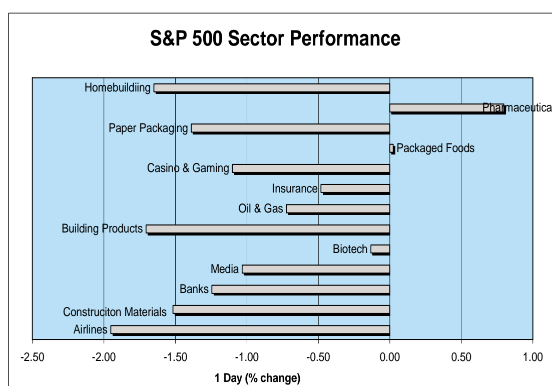
US Yesterday
24-Aug-2010

US Performance Indicators

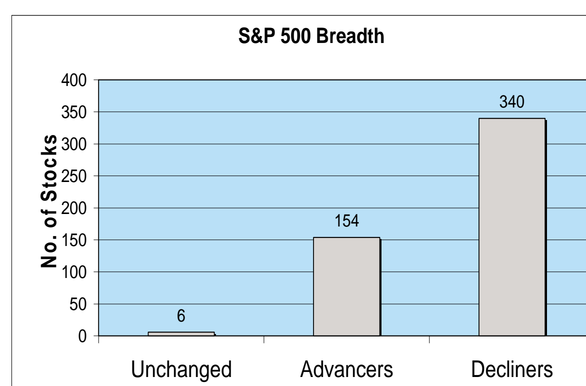
	Direction	Value	Performance % 1 Day	3 Mth	YTD
S&P 500	↓	1067.36	-0.40	-0.59	-4.28
NASDAQ	↓	2159.63	-0.92	-2.44	-4.83
DJIA	↓	10174.41	-0.38	1.07	-2.43
RUSSELL 2000	↓	602.67	-1.33	-6.01	-3.63

S&P 500 Index Volume as % of 3 mth avg: **70%**

US Sector Performance



US Breath — A / D Ratio: **0.45**



Individual Stock Perfomance

Best performers

Short_Name	Country	Sector	Price	% Change 1 Day	** % Avg Daily Volume
WASHINGTON POS-B	US	Publishing-Newspapers	368.78	6.07	222
MICRON TECH	US	Electronic Compo-Semicon	7.38	3.65	70
AVON PRODUCTS	US	Cosmetics&Toiletries	29.79	2.72	73
SUPERVALU INC	US	Food-Retail	10.33	2.48	115
FEDERATED INV-B	US	Invest Mgmnt/Advis Serv	20.89	1.95	108
AMEREN CORP	US	Electric-Integrated	27.66	1.92	130
WAL-MART STORES	US	Retail-Discount	51.14	1.83	86
HELMERICH & PAYN	US	Oil&Gas Drilling	36.96	1.73	110
CVS CAREMARK COR	US	Retail-Drug Store	28.47	1.71	109
CMS ENERGY CORP	US	Electric-Integrated	17.33	1.70	97

Worst performers

Short_Name	Country	Sector	Price	% Change 1 Day	** % Avg Daily Volume
TITANIUM METALS	US	Non-Ferrous Metals	18.46	-4.50	63
FLIR SYSTEMS	US	Electronic Measur Instr	25.24	-4.25	134
INTUIT INC	US	Applications Software	42.83	-3.97	274
CUMMINS INC	US	Engines-Internal Combust	76.50	-3.79	66
MACY'S INC	US	Retail-Regnl Dept Store	20.2	-3.67	81
ROBERT HALF INTL	US	Human Resources	21.99	-3.64	116
INTUITIVE SURGIC	US	Medical Instruments	282.94	-3.60	158
ANADARKO PETROLE	US	Oil Comp-Explor&Prodtn	47	-3.49	63
AK STEEL HLDG	US	Steel-Producers	13.01	-3.34	44
CARMAX INC	US	Retail-Automobile	20.84	-3.34	44

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Upcoming Events

24-Aug	**Aer Lingus**	H1 Results	Airlines
24-Aug	**CRH**	H1 Results	Construction & Materials
25-Aug	**Tullow Oil**	H1 Results	Oil & Gas Producers
25-Aug	**FBD Holdings**	H1 Results	Financials
25-Aug	**Paddy Power**	H1 Results	Gaming
25-Aug	**Glanbia**	H1 Results	Food & Beverage
26-Aug	**Diageo**	FY Results	Food & Beverage
27-Aug	**Independent News & Media**	H1 Results	Media
30-Aug	**ICG**	H1 Results	Transport
31-Aug	**Grafton**	H1 Results	Construction & Materials
31-Aug	**Kerry Group**	H1 Results	Food & Beverage
31-Aug	**Irish Life & Permanent**	H1 Results	Financials
31-Aug	**IFG**	H1 Results	Financials
22-Sep	**Ryanair**	AGM	Airlines

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1. Ratios where share price is an input are calculated using (a) the respective fiscal year average share price for historic years and (b) the current share price for current and future years.