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Research Report: Market strategy

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# Weekly Market Comment

**Saint-Gobain: Looking attractive ahead of 2009 results**

- We believe there are a number of reasons why SGO at current levels is worth looking at ahead of its full-year results on February 25th. Indiscriminate selling at times like this creates opportunities: in SGO's case, this may be one.

**Irish Life & Permanent: New business announcements generally better than expected**

- Three participants in the Irish life and pensions market provided their new business figures for 2009 last week. Converting both Aviva and Standard's figures to an APE basis, we reckon in aggregate that these three experienced a decline of around 24% (in euro terms) in sales on an APE basis. This suggests that our forecast 38% decline in Irish Life & Permanent's core APE in 2009 might be overly pessimistic.

**Irish Continental Group offers free option on recovery**

- Irish Continental Group remains supported by dividend yields of 7% and free cash flow yields of 12% and should be debt-free by 2011. In addition, the recent Norfolkline deal illustrates the value in ICG.

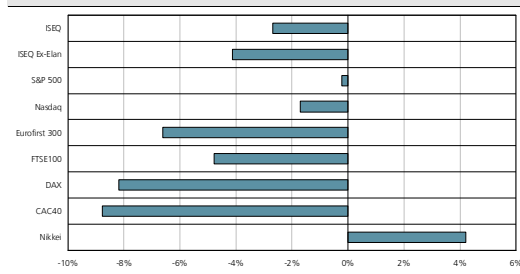
**NTR: Acceptance and delivery**

- Both BP and Shell this week demonstrated their acceptance that clean energy is the direction in which their markets are moving. NTR's investment strategy seems sound in light of these companies' comments and actions. However, NTR is not just about strategic investments; it is also about execution. NTR's wind and solar power subsidiaries will deliver renewable energy this year.

**US bakery sector**

- We do not think that CSM's acquisition of Best Brands on February 4th makes CSM any more a potent threat to ARYZTA than it was prior to the deal.

**International returns YTD (€)**



**Forecast revisions**

	2010		2011	
	Prev	Rev	Prev	Rev
Aer Lingus	-8.3	-3.0	-1.7	2.6
Buzzi Unicem	116.6	90.6	151.0	130.9
CPL Resources	7.1	14.5	14.7	20.7
DCC	178.1	175.1	184.1	179.5
Elan Corporation	-14.4	-16.8	-9.9	-8.6
Italcementi	51.7	47.3	82.3	70.4
Ryanair Holdings	17.3	20.3	28.7	28.9

**Forthcoming results and events**

	Prev. period EPS (c)	F'cast period EPS (c)
<b>Tuesday February 9th</b>		
Buzzi Unicem - trading statement		
United Drug - interim management statement		
United Drug - AGM - Shelbourne Hotel, St. Stephen's Green, Dublin 2 - 12.00		
Retail sales (Dec)		
<b>Wednesday February 10th</b>		
Air France Q3 results		
Elan Corp (USc) Q4 results		
HeidelbergCement - trading statement		
Smurfit Kappa Group FY results		
Industrial production & turnover (Dec)		
<b>Thursday February 11th</b>		
Diageo interim results		
Greencore Group - interim management statement		
Wienerberger FY results		
Greencore Group - AGM - The Crowne Plaza Hotel, Northwood Business Park, Santry, Dublin 9 - 11.00		
Consumer price index (Jan)		
Vehicles licensed for the first time (Jan)		

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## Saint-Gobain: Looking attractive ahead of 2009 results

### Analyst: Flor O'Donoghue

A long period of silence (since October 22nd) will come to an end for Saint-Gobain (SGO) on February 25th when the group announces preliminary results for 2009. As usual, the announcement will come after the close of business in Europe.

The stock has disappointed recently. After recording very strong gains in H2 2009 (+60%, having fallen 20% in H1), since the start of the year SGO has declined circa 14% and has underperformed the E300 Construction & Building Materials index by almost 5%. It is now back to end-August levels.

Some of the recent weakness clearly relates to the wider phenomenon of what has become a much more risk-averse investment climate. How long this will continue is uncertain.

That said, and while remaining cognisant of the vagaries of near-term sentiment, we believe there are a number of reasons why SGO at current levels is worth looking at ahead of the full-year results.

First, the group's valuation is attractive as a potentially strong earnings rebound makes a mockery of its current rating. Even if we assume no meaningful recovery in revenues, EPS could still get to 475c on a mid-cycle margin basis. On this basis, SGO's effective P/E is under 7x, whereas its mid-cycle P/E should be around 11x.

Second, we believe the turning point for earnings has been reached. SGO has flagged that H2 2009 earnings will be better than H1 (helped by cost savings), and we are forecasting a near-€300m improvement in H2 over H1 EBITDA (from €1.7bn to €1.95bn). Core end-markets are showing signs of healing (for example, French housing and flat glass). Reflecting this, consensus 2010 earnings estimates have been trending upwards. Management has also alluded to the potential for a very sharp bounce in margins in 2010.

Third, the earnings result from the second half of 2009 onwards will also benefit from aggressive actions on costs. Cost savings projections are now up to €1.5bn, which are estimated to be coming through as follows: €400m in 2008; €1,100m in 2009, with some €400m of the 2009 savings coming through fully in 2010.

Finally, there is no material balance sheet stress as pre-emptive action was taken with the capital raising in H1 2009, underpinning already decent underlying cash generation.

All this marks a contrast to this time last year when serious question marks hung over SGO's earnings outlook and balance sheet position. Indiscriminate selling at times like this creates opportunities: in SGO's case, this may be one.

## **Irish Life & Permanent: New business announcements generally better than expected**

### **Analyst: Emer Lang**

Three participants in the Irish life and pensions market provided their new business figures for 2009 last week. Aviva reported a 25% decline in its Irish sales in local currency terms on a PVNBP (present value of new business premiums basis = single + PV of annual premiums) basis; Standard Life reported a 21% fall on a similar basis (including offshore bond sales); while Zurich reported an 11% decline on the traditional APE basis (APE = Annual + 1/10th Single premiums).

Converting both Aviva and Standard's figures to an APE basis, we reckon in aggregate that these three experienced a decline of around 24% (in euro terms) in sales on an APE basis. This compares with Zurich's estimate that the overall market declined by 26% and implies that the other market participants (primarily Irish Life & Permanent (IPM), Bank of Ireland Life, Canada Life and Friends First) in aggregate fared a bit worse than this. However, it also suggests that our forecast 38% decline in IPM's core APE in 2009 might be overly pessimistic. The group's latest guidance dates back to its November 17th IMS, when it predicted that core Retail and Corporate APE sales would be approximately 35% lower in FY 2009. This pre-dated an apparent pick-up in pension-related business ahead of the December budget.

In IPM's case, pensions are its biggest product - accounting for over 60% of sales in APE terms in FY 2008. At the interim 2009 stage, IPM put its share of the pensions market at c.34%. Better volumes may also help the life margin: IPM's latest guidance put its life new business margin (APE basis) for the year in the range of 9-10% (we assume 9.5%), well down on 2008's 15.1% level. Zurich enjoyed a 19% increase in its new business profits in Ireland despite the decline in sales due to 'a successful focus on protection business particularly in the group protection market and also through effective expense control'.

The week ended on a good note for the sector with news that pensions are to escape the 1% level on insurance premiums. It remains uncertain whether individual players planned to pass the levy on to customers or absorb it themselves, but either way the news is positive.

## Irish Continental Group offers free option on recovery

**Analyst: Stephen Furlong**

In the shipping sector, we continue to like Irish Continental Group (ICG). ICG remains supported by dividend yields of 7% and free cash flow yields of 12% and should be debt-free by 2011.

The recent Norfolkline deal (the A.P. Moller-Maersk Group and DFDS agreed on December 17th that DFDS will acquire 100% of the shares in ferry and logistics company Norfolkline) illustrates the value in ICG. The EV/EBITDA multiple on Norfolkline's reported 2009 EBITDA is 11.9x; even at trough 2009 earnings levels, ICG is trading at 7.7x EV/EBITDA. With the above deal cited as synergy potential, the group's short-term focus is to "facilitate a turnaround of operations on the Irish Sea, which have been severely impacted by the economic downturn". So some capacity discipline but also recovery - notably in exports - should drive ICG, whose bottom line benefits materially from operating leverage.

In aggregate, the business has an extremely high fixed cost base and so is heavily leveraged to volumes in both directions (75-80% of incremental revenues fall to the bottom line in ferries). ICG earned €80m EBITDA in FY 2007 (Davy's 2010 forecast is for EBITDA of €55m). If volumes returned to 2007 levels, the group could likely earn another €5-10m in EBITDA given the cost-cutting programme in the interim.

Stabilization and some recovery will have a dramatic impact on EBITDA. For ICG, car volumes were down 4% in H1 2009 but have recovered since then (up 2% in July-October). With combined commercial air traffic at Dublin, Cork and Shannon decreasing by 21% last year compared with 2008, ICG is seeing some substitution away from the airlines as capacity is taken out. Volumes in the freight RoRo market were down 17% in H1, but the rate of decline now appears to have troughed. As well as normal leverage to a modest multiple on GDP, we would expect some positive effects from restocking and note that the above deal is likely to result in capacity reduction in the marketplace. In addition, we forecast that exports will expand by 3.5% in 2010 and by 6% in 2011.

ICG has established itself as a good-quality ferry and shipping company. Its business model is based on scale operating assets that are managed with high utilisation and through control of valuable slots in constricted ports in Ireland (Dublin) and Wales (Holyhead and Pembroke). In parallel, ICG operates a very flexible, low-cost labour force compared with other ferry companies in north-western Europe.

## **NTR: Acceptance and delivery**

### **Analyst: Caren Crowley**

BP and Shell are not names traditionally associated with clean energy. However, this week both companies demonstrated their acceptance that clean energy is the direction in which their markets are moving. NTR, with its portfolio of clean energy solutions, represents a direct play on the accepted future of the energy market.

In a speech on February 4th, BP's CEO, Tony Hayward, is reported to have admitted that BP takes an assumed price of carbon dioxide (CO<sub>2</sub>) emissions into account when making investment decisions. The assumed price is double the current price of some €13 per tonne of CO<sub>2</sub> under the EU's emissions trading scheme. This assumption is to ensure that BP's energy investments are economic "in a future where carbon has a more robust price" in order to make renewable energy more competitive.

While BP 'talked the talk', Shell went one step further this week and 'walked the walk'. Through a \$12bn joint venture with Brazil's Cosan, Shell entered the ethanol production industry. Shell will put \$1.6bn of cash into the joint venture over the next two years; this investment shows how serious Shell is taking biofuels and what it is prepared to pay in order to play catch-up in the first generation biofuels sector.

NTR has material equity in zero-carbon energy projects through its stakes in Wind Capital Group (WCG) and solar power provider SES Tessera Solar. NTR also has exposure to biofuels production through its 45% shareholding of GPRE, the fourth-largest producer of corn-based ethanol in North America. NTR's investment strategy seems sound in light of BP's and Shell's comments and actions. However, NTR is not just about strategic investments; it is also about execution. NTR's wind and solar power subsidiaries will deliver renewable energy this year. Having raised \$240m of debt finance in 2009, WCG's 150MW Lost Creek wind power project is now producing test power and will commence commercial production soon. In January, the 1.5MW Maricopa solar power project was completed and is a successful precursor to larger-scale commercial projects.

We don't believe NTR's current share price of 250c fully recognises management's strategy and delivery; our target price is 460c.

## US bakery sector

### Analyst: John O'Reilly

If CSM had a better history in bakery, then one might be inclined to use the 8.5x EV:EBITDA multiple that it paid to acquire Best Brands (\$538m of revenues which were acquired for \$510m) as a valuation benchmark in the sector. Its historic performance in part baking is awful, as we have observed previously. It has retreated from this to concentrate on bakery ingredients, which (as far as we can figure out) is the main part of Best Brands' business. It has some manufacturing (muffins, frozen dough and croissant), but in-store bakery is its main focus with mass market retail (including Wal-Mart) its principal channel.

For its part, CSM in US bakery is mostly about ingredients, although it also has some manufacturing capability. But neither CSM nor Best Brands has ARYZTA's attested market positions in artisan-style bread (La Brea) or frozen cookie dough (Otis Spunkmeyer). We do not think that the deal (announced on February 4th) makes CSM any more a potent threat to ARYZTA than it was prior to the deal. CSM has stretched itself to acquire Best Brands and is doing so at a time when US bakery, even if comparatively stable, is nonetheless challenged by the general economic circumstance.

The US bakery reporting season is a story of volume slowdown/attrition, migration to value products and channel switching by consumers - the effects of which are (currently) being offset by easier input costs (although relatively this depends on the product portfolio). ARYZTA has experienced a sharp deceleration in topline growth in its US operations. For comparative purposes, we estimate FY2009 EBITDA of c.15% for ARYZTA's US operations; it was 11.2% at Best Brands.

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