

## DAVY MORNING EQUITY BRIEFING

29 July 2010

### MARKET COMMENT

**Fed's Beige Book confirms US slowdown** US economic growth is slowing, albeit not dramatically. That was the impression conveyed in the Fed's latest Beige Book, or regional survey of activity. Manufacturing activity softened, housing has definitely dipped since the homebuyer tax credit expired on April 30th and the outlook for consumer spending is somewhat weaker. Nonetheless, the economy is still expanding, if not as quickly as it was to the end of May. The ISM manufacturing reading is even more likely to disappoint next Monday. [more](#)

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**Thursday July 29th;** United Drug - interim management statement. Travis Perkins interim results. Saint-Gobain interim results. Lufthansa Q2 results. **Friday July 30th;** Overseas travel, May. Credit aggregates, Jun. Lafarge interim results. Italcementi interim results. Iberia Q2 results. HeidelbergCement interim results. British Airways Q1 results. **Tuesday August 3rd;** Taylor Wimpey interim results. **Wednesday August 4th;** Donegal Creameries - ex-dividend - final dividend rate - 9.0c. **Thursday August 5th;** Bellway - trading update. Ladbrokes interim results. C&C Group - AGM - The Shelbourne Hotel, St. Stephen's Green, Dublin 2 - 12.00. **Friday August 6th;** PartyGaming interim results. **Monday August 9th;** Dragon Oil interim results. **Tuesday August 10th;** Buzzi Unicem interim results. **Wednesday August 11th;** Bank of Ireland interim results. Smurfit Kappa Group interim results. **Thursday August 12th;** Geberit interim results.

#### Please refer to important disclosures at the end of this report

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**MARKET COMMENT****Fed's Beige Book confirms US slowdown****Rossa White**

US economic growth is slowing, albeit not dramatically. That was the impression conveyed in the Fed's latest Beige Book, or regional survey of activity. Manufacturing activity softened, housing has definitely dipped since the homebuyer tax credit expired on April 30th and the outlook for consumer spending is somewhat weaker. Nonetheless, the economy is still expanding, if not as quickly as it was to the end of May. The ISM manufacturing reading is even more likely to disappoint next Monday.

This survey covers the period to July 19th, so it is close to real-time. Following the recent disappointing regional manufacturing indices from New York, Philadelphia, Chicago and Dallas, it is worth noting what the 12 Fed districts had to say overall. This is significant ahead of next Monday's ISM index for July. Manufacturing moved up in aggregate, but half of the districts reported that it slowed or levelled off. With regard to consumer spending, the outlook is perhaps of most relevance. Three districts were less optimistic than they had been about future spending. But the trend in recent retail sales has generally been solid, if unexciting.

We noted that yesterday's US mortgage applications index for last week dipped again. On a four-week average basis, the index is back to its lowest level since 1996. And it has slumped noticeably since the ending of the incentive to buy three months ago. The Beige Book confirmed that housing is weak: 'nearly all districts reported sluggish housing markets in the months since the homebuyer credit expired'. Meanwhile, commercial property markets 'continued to struggle in all twelve districts'. Excess supply issues aside, the US property market will find it difficult to recover until credit conditions normalise. Even though the last couple of (separate) Fed senior loan officer surveys have shown improvement, this survey stated that 'most districts reporting on credit standards continued to note that lending standards remain restrictive'.

**CONSTRUCTION AND BUILDING MATERIALS****Travis Perkins (TPK LN)**

Price:830p Rating:Outperform Issued:30/06/09

**Another excellent set of results led by merchanting division; clear upside to 2010 forecasts****Flor O'Donoghue**

**FACTS:** Travis Perkins (TPK) has announced results (July 29th) for the six months to end-June. The group has reported revenues of £1,522m, up 5% year-on-year (yoy) and underlying operating profits of £120m (+1% yoy). In addition, there was a negative exceptional item charge of £4.6m while the group's net interest charge fell from £27.2m to £8.6m. Pre-tax profits for the period were £107.2m, or £111.8m on an underlying basis (+24% yoy). First-half diluted adjusted EPS of 38.7p, down 7% on H1 2009, reflects a c.30% yoy increase in the group's number of shares in issue following the equity raising last year. As previously announced, TPK proposes to pay a H1 dividend of 5p per share. Net debt at end-H1 was £410m, down £57m from £467m at end-2009.

Presentation/conference call at 09.00 (Ireland/UK time) at: 0 800 694 1565 (UK free-call); +44 (0) 1452 586 009 (UK); 1 866 245 1332 (US free-call); pass-code 82409113.

**ANALYSIS:** TPK's H1 revenues were effectively pre-announced at the start of July so there is no surprise in the top-line performance. Merchanting revenues rose 6% to £1,020m (67% of group) while retail revenues rose 2% to £502m. Underlying operating profit is £94.1m in merchanting (+12% yoy) and £26.3m in retail (-25% yoy). We had forecast underlying operating profits of £113.5m, so the result is 6% better than we had expected. This is driven by another excellent merchanting result. The H1 merchanting margin of 9.2% is up on H1/H2 2009 (8.7%/8.8%) while, as expected, the first-half retail margin of 5.2% is down on the excellent H1 result last year (7.2%). We had forecast diluted adjusted EPS of 34.5p, so TPK has come in 11% ahead. The continuing reduction in net debt is also positive — it would have been a good deal lower except for a one-off £34.7m pension-related item — and will clearly help bolster TPK's financial position ahead of the expected acquisition of BSS. On current trading, the patterns evident in May and June have largely continued. Like-for-like revenues in merchanting in July are up 10% while core like-for-like sales in Wickes are down 1.1%. TPK still believes that the recovery in the UK will be uneven, with trade up and retail down.

**DAVY VIEW:** TPK has delivered another highly impressive set of results. Like-for-like sales growth presents a strong platform for a good second half. Ex BSS, our current forecasts imply revenue growth of just 1% yoy in H2 and a merchanting margin of 8.1%. This is clearly too low and the knock-on impact suggests a diluted adjusted EPS for the year c.5% above our current forecast of 70p. While we are concerned that the current growth in the UK housing market might peter out by year-end, the addition of BSS next year will add fresh impetus, and EPS of 85p and possibly higher is feasible. This would leave the stock on a prospective P/E of under 10x, which is much too cheap for a proven business of this quality

**Company summary and analysis**

**Travis Perkins (TPK LN)**

Price: 830p Rating: Outperform Issued: 30/06/09

**More good news: strong trading statement from BSS with underlying revenues up and costs down****Flor O'Donoghue**

**FACTS:** BSS has issued a trading update (July 29th) covering the period from April 1st to July 28th. Like-for-like revenues in this period have risen 7%, underlying costs are c.2.6% lower year-on-year and gross margins have improved.

**ANALYSIS:** BSS continues to perform impressively. Like-for-like revenue growth in the period was 7% in its Domestic division, 5% in its Industrial division and 8.5% in its Specialist business. According to BSS, the positive gross margin trends reflect selective price increases, purchasing benefits and revisions to trade terms.

**DAVY VIEW:** Based on current trading, Travis Perkins will be acquiring BSS at a time when the business has considerable momentum, with good revenue growth and improving margins. The transaction is not expected to close until Q4 but will be immediately earnings accretive.

**Company summary and analysis****FINANCIALS****Loan demand weakened further in Q2****Stephen Lyons**

**FACTS:** The Irish bank lending survey revealed that loan demand weakened further in Q2 for both enterprises and households across all categories examined. Credit standards were unchanged on loans to enterprises and tightened marginally on loans to households for house purchase.

**ANALYSIS:** Demand for house purchase loans has been in decline since mid-2006, in line with the negative sentiment for housing market prospects and consumer confidence – both of which had further negative readings in Q2. The trend is similar to demand for consumer credit, where finance needs for spending on durable consumer goods has witnessed a similar decline and also had a negative reading in Q2. The margin on house purchase loans was a negative factor in Q2 having been stable over the four preceding quarters. There is no change in credit standards expected for households over the next three months, but, interestingly, there is small positive reading for expected change in the demand for house purchase.

Demand for credit lines for enterprises has also been in steady decline since the beginning of 2007. The biggest factor affecting demand is debt restructuring, which has been a positive driver of credit demand in the last year. In comparison, financing needs for fixed investment has been negative since early 2007. The margins on average loans have tightened significantly since early 2007 and continue to do so, albeit at a lower pace now, and it is perception of risk that is the greater influence on this tightening. There is no change in either demand or credit standards expected over the next three months.

**DAVY VIEW:** In the recent quarterly review from the Credit Review office into SME lending, the report highlighted that SMEs will require more working capital in the near future, to re-stock and take on more debtors, and the requirement for bank support will grow in the coming months. The latest bank survey reading does not indicate that this increased support is available. When the Irish banks have fully restructured and recapitalised, this greater support will hopefully be available. Banks' balance sheet and funding constraints are disincentives to provide this additional support, but a balance needs to be struck to overcome this and assist the domestic recovery.

**Sector valuations****ECB tightens collateral rules****Stephen Lyons**

**FACTS:** The ECB has published a new schedule, tightening the rules for assets eligible as collateral in its market operations. The new haircut schedule will come into effect from January 1st 2011.

**ANALYSIS:** The new schedule graduates haircuts according to difference in maturities, liquidity categories and the credit quality for the assets concerned. Haircuts for sovereign debt rated in the AAA to A- range have not been changed. Top-rated government debt will carry a haircut of as low as 0.5%, with the most penal haircut of up to 69.5% for lower quality "inverse floaters". An additional mark-down of 5% on asset-backed securities will also be applied to theoretically valued bank bonds.

The ECB does point out that the new haircuts will not imply an undue decrease in the collateral available to counterparties. According to Reuters, only 4% of collateral used by banks for ECB funding in 2009 was below A quality (where the biggest changes are).

From an Irish perspective, the banks' ECB funding reliance had been falling since the peak in June of last year. In May, however, the balance increased as funding markets shut on peripheral sovereign concerns. Drawings by retail clearers at the end of May were €25.6bn versus a peak of €46bn. The number of mortgage lenders was €44.8bn, down from the peak of €72bn. The June numbers, which should be available tomorrow (June 30th), are likely to have increased further but are also likely to be distorted as banks pre-funded themselves ahead of the ECB's July 1st €442bn redemption.

**DAVY VIEW:** The tightening of the rules is unlikely to have much impact on the European banking system as early signs are that the stress tests will help improve interbank funding and thus reduce ECB reliance. Given the bunching of term funding (which matures for the Irish banks this September) and the fact that, with the exception of Bank of Ireland, sector restructuring still has a way to go, the ECB facility will remain an important funding source in the short term (especially as a contingency facility to reduce liquidity risk). Significantly, the Irish banks' liquidity pools are set to be boosted by €40bn of NAMA bonds by the end of this year (or by February 2011 at the latest). These have the equivalent of a sovereign rating and will not be affected by these changes.

#### Sector valuations

## PHARMA AND HEALTHCARE

### United Drug (UDG ID)

Price:239c      Rating:Outperform      Issued: 30/06/09

#### IMS meets expectations

Jack Gorman

**FACTS:** United Drug (UDG) has issued an IMS for the third quarter to end-June.

**ANALYSIS:** UDG has reiterated its FY guidance after trading in line with expectations for the nine months to date. Cash flows, a very positive feature of the H1 out-turn, continue to be strong throughout the group. PBT for the full year is expected to be in line with last year's on a constant currency basis (the yoy effect of FX is quite limited so far).

The overview of divisional performance reads positively, incorporating the already highlighted challenges that face some elements of the group.

Healthcare Supply Chain: although the February 2010 price reductions on off-patent medicines have reduced the value of the Irish wholesale market, UDG has offset some of this by winning market share in the period. As expected, trading in Medical/Scientific remains very difficult as capital spending remains severely constrained. That said, this is creating new outsourcing opportunities as medical device manufacturers consider whether to retain their own commercial infrastructure in these markets – UDG has secured a number of business wins here. UDG's specials business in the UK is also sustaining its strong profits growth into the second half of the year (estimated 12% of group EBITA).

Contract Sales & Marketing: this division is continuing to trade strongly in a market described by UDG as "buoyant". Again, increased outsourcing penetration has created a strong pipeline of business opportunities. Its US marketing services (medical affairs, patient compliance etc) has already exceeded all targets for the current year. The Events Management units in the UK and US are rebounding after a slow start. Its core CSO offering in the UK, AshfieldIn2Focus, has also won new clients and expanded some existing client business.

Packaging & Speciality: profits are ahead year-to-date, notwithstanding start-up costs associated with Medco (more of the latter may occur in the final quarter). Packaging profits are well ahead of last year, as expected, with Sharp predominant. The Medco homecare JV has started well. The Masta vaccines operation is struggling given the downturn in travel vaccines, especially due to the ash clouds earlier in the year.

**DAVY VIEW:** UDG is inexpensively rated (P/E c.10x) and offers a decent yield of 3.8% ahead of a return to growth which is forecast for next year. Its investment in specialist supply chain services, originally in contract sales and more recently in packaging/homecare etc., offers the greatest prospect of long-term growth as the regulated business in Ireland generates cash. The rating will expand as this growth fully materialises.

#### Company summary and analysis

### United Drug (UDG ID)

Price:239c      Rating:Outperform      Issued: 30/06/09

#### Dutch peer lowers organic growth target

Aiden O' Donnell

**FACTS:** Mediq, an indirect peer of UDG in Dutch and European supply chain outsourcing, lowered its FY organic growth targets to a 2-3% range from a previously guided 3-5% range. A decline in sales in its Belgian pharmaceutical division weighed on the current quarter's results.

**ANALYSIS:** The company delivers in three channels – directly to patients' homes (Mediq direct), to hospitals and nursing homes (Mediq institutional) and via its own pharmacy division.

**DAVY VIEW:** The direct and institutional division, which is a similar to the home care operation that UDG is building in the UK and Irish markets, grew sales at 11% (albeit aided by an acquisition in the Nordics). On an organic basis, the division grew 2%.

#### Company summary and analysis

**ICON (ICLR US)**

Price:\$24.07 Rating:Outperform Issued: 22/07/09 Previous: Neutral Issued: 30/06/09

**Covance lowers FY guidance on poorer H2 outlook****Jack Gorman****FACTS:** Covance issued Q2 numbers after US markets closed last night (July 28th).**ANALYSIS:** Headline Q2 numbers were in line with expectations, with net revenues up 2% year-on-year (yoy) and EPS of 49c (adjusted 58c) versus 67c last year.

Its early-stage division (mostly pre-clinical, Phase I) posted 4.2% revenue growth, though operating profit fell by 17% yoy due to cost rationalisation charges (margins would have increased by 40bps otherwise).

Late-stage development division is more akin to ICON, though its central lab unit is much larger. Revenues edged forward by 0.3% and operating income fell by 13.7% — the latter was negatively impacted by three large contract delays announced earlier in 2010.

Bookings were solid but not spectacular. Net book-to-bill was 1.14x, or 1.24x including dedicated contracts. Coming off low bookings in Q1 as well, Covance has revised down its FY guidance. Revenue growth is now targeted at 2-4% from 5-8% previously; EPS of 210-230c compares with 240-265c previously though the former includes 11c of cost reduction programmes.

**DAVY VIEW:** Covance's revised guidance may spook the sector further, though its poor wins in Q1 had already created a requirement for a very strong Q2 in terms of bookings. As we noted for ICON, sector recovery is underway though it will take a few more quarters for it to support strong top-line acceleration.**DAVY VIEW:** [Insert body text here]**Company summary and analysis****TRAVEL AND LEISURE****Lufthansa (LHA GY)**

Price:1280c Rating:Outperform Issued: 14/09/09 Previous: Underperform Issued: 30/06/09

**Solid Q2 and back in operating profit****Stephen Furlong****FACTS:** Lufthansa has reported its interim results; an analyst call will take place at 13.30 GMT.**ANALYSIS:** Lufthansa earned an operating profit in the second quarter and expects an improved operating result for the full year, in line with market expectations.

The Lufthansa Group closed the first half of 2010 with revenue of €12.6bn (last year: €10.2bn) and an operating loss of €171m (last year: +€8m). The net loss for the period came to €104m (last year: -€178m). In the second quarter, the operating result was €159m (last year: €52m) from revenue of €6.9bn (last year: €5.2bn).

The airline commented that "On the one hand, the result of the first half-year reflects a positive demand trend, above all in the freight and intercontinental passenger businesses. On the other, it includes adverse effects such as rising fuel prices and the first-time consolidation of Austrian Airlines and bmi, as well as non-recurring factors like the extreme winter, the strike by cockpit staff and airspace closures in April as a result of the volcanic eruption in Iceland".

Lufthansa comments that the momentum behind the performance of the business has "further increased the confidence to reach our profitability targets". It therefore continues to expect higher revenue. The Board still anticipates an improvement in the operating profit, which on today's estimates should be in line with market expectations (the current median estimate for FY2010 is €379m).

These numbers are broadly in line with market expectations, and we are unlikely to see a material change in estimates.

**DAVY VIEW:** At 5x EV/EBITDA and adjusting for off-balance-sheet and pension obligations, the stock would trade at close to 1500c. This is at a discount to our sum-of-the-parts analysis, which values the group at over 1700c.**Company summary and analysis**

## US online gambling bill passed by House Financial Services Committee, now moves to the main floor of Congress

**David Jennings**

**FACTS:** A bill that would regulate and tax internet gambling in the US was passed by the House Financial Services Committee of Congress yesterday evening (July 28th). The bill was passed by 41 votes to 22 with one-third of Republicans on the committee supporting it. The bill now moves to the main floor of Congress and awaits the passage of a corresponding tax bill.

**ANALYSIS:** The bill is designed to allow US-based companies to obtain licenses and operate federally-regulated online gambling sites, allowing them to accept bets from US customers. The key points within the bill are as follows:

- The Secretary of Treasury would have overall responsibility for regulation of the industry and would be responsible for issuing online gaming licences. Licences would be issued for five-year terms, at which time operators can apply for renewal.
- Sports betting is not included in the bill. The bill allows for online poker and online casino in certain circumstances.
- The bill includes a 'state opt-out' provision, which gives each state's governor the option to block the federal bill from applying in his/her state. A similar 'opt-out' provision for Indian tribes on their lands is also included.
- The onus is removed from financial transaction providers: HR 2267 explicitly notes that financial transaction providers will not be held liable under any other law (e.g. UIGEA) for allowing customers to transfer funds to and from federally licensed online gambling sites.
- Key amendments made to the bill yesterday include:
  - Sites that have intentionally broken Internet gaming laws cannot get a licence to conduct business in the US. This is aimed at those operators that have continued to accept bets from the US since UIGEA came into effect.
  - The facilities of licensees that operate and/or accept wagers must be located in the US.
  - Bettors must be at least 21 years of age, and both the age and residence of bettors must be verified.
  - The odds of winning at each game must be posted online (presumably this will apply only to casino games).
  - The identities of legal and illegal gambling sites must be verified by the Treasury in order for banks to prohibit certain financial transactions.
  - Sites must provide loss limits for each bettor and only debit cards, not credit cards, will be allowed to transact on the sites.

**DAVY VIEW:** There are two ways to look at this development. On the one hand, this is an important step in the potential passage of online gaming regulation in the US. Most bills never make it out of committee stage, and the fact that it has been passed with bipartisan support is certainly encouraging. On the other hand, there is still a long way to go for this bill to become law and a limited time-span for it to happen. A corresponding tax bill on internet gambling still needs to be passed through the committee before the House can vote on both. If passed by the House, the bills would then move on to the Senate. As of yet, there have been no Senate hearings on a corresponding bill. Congress breaks up at the end of September, ahead of mid-term elections at the beginning of November. While the legislation could be passed in a lame duck session following the mid-terms, the speed at which the tax bill is passed and developments in the Senate occur will be critical.

PartyGaming is trading on a forward P/E of just 13.5x at present and therefore is inexpensive on an underlying basis. We view the possible opening of the US market almost as a shot to nothing at this point; should legislation be passed, there is significant upside yet very little is priced in. As such, the risk-return dynamic looks favourable to us at this point.

### Sector valuations

## FOOD AND BEVERAGE

### Glanbia (GLB ID)

Price: 322c      Rating: Outperform      Issued: 30/06/09

### NBTY reports third-quarter results

**Aiden O' Donnell**

**FACTS:** NBTY reported results after the US market close last night (July 28th). The results came in well ahead of analysts' expectations at the EPS level and were in line on a revenue basis.

**ANALYSIS:** The earnings release notes some overall industry data and indicates that sales of vitamins, minerals, herbs and other supplements in the food, drug and mass market sectors increased by 9.8% (Nielsen data) in the quarter. NBTY grew same-store sales in the US by 2% and by 1% in Europe. The contribution to revenues from its online platform also increased.

**DAVY VIEW:** NBTY, as we have noted previously, announced on July 14th that it is to be acquired by the Carlyle group for \$3.8bn. The nutrition business, in which Glanbia operates through Optimum Nutrition, continues to be an exciting space, further enhanced by the interest shown by private equity.

### Company summary and analysis

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## SUPPORT SERVICES

### DCC (DCC ID)

Price: 1854c      Rating: Outperform      Issued: 30/06/09

### Distributor sales show IT industry recovery accelerating in US and Europe

**Caren Crowley**

**FACTS:** The Global Technology Distribution Council (GTDC) reported that the IT industry recovery continues to gain strength, led by substantially stronger US market sales and increased stabilisation in Europe. The GTDC's industry trends are based on actual sales results of its members, who are some of the world's largest IT distributors, representing more than \$100bn in annual sales. DCC Sercom is a member of GTDC.

**ANALYSIS:** Second-quarter year-over-year sales in Europe increased by 15%, and June sales finished up 20% over the corresponding period last year. Overall, Q2 sales remained in-line with anticipated seasonality trends.

GTDC also reported that small, medium and large enterprises are investing more heavily in networking, storage and other IT infrastructure and that the solutions and services provided by IT distributors are becoming more diversified, including a growing number of products that would have been sold exclusively through other channels in the past.

**DAVY VIEW:** Growth in Q2 sales for the IT distribution industry, as reported by the GTDC, is encouraging although it is not the most significant trading period for DCC Sercom.

GTDC's remarks on diversification trends are in-line with DCC Sercom's strategy for the market. DCC Sercom has expanded its product offering and customer base; this has helped it to report resilient operating profits despite a challenging market.

DCC Sercom generates some 20% of group EBITA.

Company summary and analysis

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## MEDIA AND TECHNOLOGY

### Trinity Mirror H1 results; revenues flat, profits ahead of expectations

**Simon McGrotty**

**FACTS:** Trinity Mirror has reported first-half results for the 26 weeks to July 4th. Group revenues were flat at \$382m, or down 5% on a like-for-like basis. Operating profits increased £26% to £61.7m, which resulted in a 330bps increase in operating margin of 16.1%.

**ANALYSIS:** Within the divisional mix, the Nationals business saw a 2.2% increase in advertising rates, but declines in circulation revenues of 6.2% and no cover prices resulted in a marginal fall in revenues of 3.4%. Strong double-digit advertising rate growth was achieved in June, in part driven by the World Cup. Like-for-like advertising revenues in the regional's business fell 8%, in line with what has been reported by peers in recent weeks. Although it is still negative, it does represent an improvement from the 23.5% decline experienced in 2009. Circulation revenue declined by 7.4% over the period. The significant increase in profits and margin was driven by a £29m like-for-like reduction in total costs, this is ahead of the group's expectations and it has consequently increased its target for structural cost savings by £5m to £25m for the full year.

In terms of current trading, management notes that the improvement seen in advertising trends during the first half is expected to continue into H2, with the additional expectation of continued month-on-month volatility. Advertising revenues in July are expected to be flat for the Nationals division and to decline by 9% in Regionals, with each area expected to see a 6% fall in circulation revenue.

Management continues to remain cautious about the economic outlook but remains confident of achieving a robust performance for the full year.

**DAVY VIEW:** These numbers appear to be ahead of the market's expectations, particularly at the operating level. Taking the first half run rate of £61.7m would result in full-year operating profit of £123.4m versus current consensus of £113.8m. While advances are being driven by continued cost take-out, there are signs of a gradual recovery in advertising rates, particularly at the National level. The decline in circulation revenues needs to be stemmed to get a meaningful recovery in the top line.

Sector valuations

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## RESOURCES AND ENVIRONMENT

### Petronet (PTR LN)

Price: 42p      Rating: Outperform      Issued: 18/12/09      Previous: Neutral      Issued: 30/06/09

#### First production expected in late August

James McCullough

**FACTS:** PetroNeft has confirmed that it expects to commence year-round pipeline oil production in late August (previous guidance had been for first oil in Q3). This follows the completion of the fifth and sixth production wells ahead of schedule and near completion of the field production facilities.

**ANALYSIS:** The fifth and sixth production wells have intersected some of the thickest net oil pay to date at 15.8 metres and 14.0 metres respectively, with both intervals completely saturated with oil. This brings the average pay of the six wells drilled to date to 12.6 metres versus our assumption of 12.5 metres. These results are reassuringly in line with expectations, as indeed the entire development project has been, and the initiation of first production is now just a matter of weeks away.

The key obstacle remaining is hitting the production ramp-up schedule, but there has been nothing to suggest that PetroNeft's target of 4,000 barrels of oil per day by the end of the year will not be achieved. In fact, we see this as a reasonably conservative target, and we forecast 2011 EBITDA of over \$60m.

Rig-up operations for the Arbuzovskaya exploration well are now complete, and the well is due to commence in October. This is the first of at least three exploration/appraisal wells in 2010/2011 with potential to add near-infrastructure reserves. The Arbuzovskaya well itself is targeting 16m barrels of oil with potential to add 6p per share to our 76p per share valuation; the other two definite wells are likely to be on Sibkrayevskaya (44m barrels) and Kondrashevskoye (18m barrels).

**DAVY VIEW:** We continue to see PetroNeft as a top-pick, notwithstanding the very strong performance over recent months. The transition from explorer to producer will be a key event in the company's history, and we see great potential for continued organic growth over the next few years. We maintain our 76p per share risked valuation (352p unrisks) and our 'outperform' rating.

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)	2911.5	-32.3	-1.1
ISE Financials Index	867.7	-5.6	-0.6
ISE General Index	3630.1	-42.3	-1.2
ISE Small Cap Index	1658.3	23.8	1.5
<b>SECTOR INDICES</b>			
FTSE E300 Constr. & Mats.	1350.6	-11.5	-0.9
FTSE E300 Food Producers	1500.0	-3.6	-0.2
FTSE E300 Travel & Leisure	1149.5	-12.9	-1.1
<b>EUROPEAN MARKETS</b>			
FTSE Eurofirst 300	1050.9	-3.3	-0.3
FTSE 100	5319.7	-46.0	-0.9
CAC 40	3670.4	4.0	0.1
DAX	6178.9	-28.4	-0.5
<b>US MARKETS</b>			
S&P 500	1106.1	-7.7	-0.7
Nasdaq	2264.6	-23.7	-1.0
DJIA	10497.9	-39.8	-0.4
<b>REST OF THE WORLD</b>			
ASX All Ordinaries	4542.1	28.3	0.6
FTSE/JSE Africa All Share	28367.3	-94.2	-0.3
NZ All Ordinaries	708.3	2.5	0.4
Hang Seng	21067.5	-23.7	-0.1
Shanghai SE Composite	2633.7	58.3	2.3
Nikkei 225	9690.7	-62.6	-0.6
MSCI World	815.3	0.8	0.1
<b>COMMODITIES</b>			
Brent Oil US\$/bbl	75.6	0.5	0.7
CRB Commodity Index	431.3	0.9	0.2
Gasoline US\$/gal	204.7	-1.6	-0.8
Gold \$/t oz	1162.3	0.7	0.1
Natural Gas GBp/therm	41.5	0.5	1.2
<b>EXCHANGE RATES</b>			
Stg/EUR	0.8327	-0.0009	-0.1
USD/EUR	1.2991	-0.0006	-0.1
USD/Stg	1.5594	0.0005	0.0
<b>INTEREST RATES</b>			
Euro 3 Mth Money Rate	0.90	0.00	0.3
UK 3 Mth Money Rate	0.74	-0.00	-0.1
US 3 Mth Money Rate	0.48	-0.01	-1.3
<b>BOND YIELDS</b>			
Ireland 10 Yr Bond Yield	5.00	-0.18	-3.5
Euro 10 Yr Bond Yield	2.75	-0.02	-0.7
UK 10 Yr Bond Yield	3.49	-0.03	-0.8
US 10 Yr Bond Yield	2.99	-0.06	-2.1

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		Percent	Count	Percent
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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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