

PetroNeft

Oil & Gas

Maintaining positive momentum

Closing Price: £0.60

Price Target: £0.78

BUY

- Increase & de-risking of exploration reserves...** - Since our last report on September 10th PetroNeft has: (i) held an on-site analyst visit; (ii) secured additional funding by way of a Placing last month; and (iii) provided initial results from the exploration campaign on Licence 61. All have been greeted warmly by the market, as reflected in the 25% rise in the share price in the intervening period, compared to a 19% rise for the FTSE AIM Oil & Gas Index. At the root of the outperformance, in our view, is increasing confidence that PetroNeft will deliver on production (peaking at c.18.5 kbopd in 2015 in our model) and propagate the model by way of further licence addition. Indeed, a feature of the Placing, which raised \$43m gross at 43p per share (against a closing price of 44p), was its size, suggesting funding above that required to accelerate its exploration campaigns in Licence 61 & 67 (estimated at c.\$15m) and thus the wherewithal to pursue deals as the opportunities arise. On the exploration front, the result from the Upper Jurassic interval of the Arbuzovskaya well underpins the potential within Licence 61, particularly as it, among the five scheduled wells to be drilled over the coming year, was the only structure that hadn't been previously drilled.

- ...leads to increase in valuation** - Adjustments to the model reflect: (i) the dilution associated with the Placing; (ii) an increase in our long term oil price assumption from \$80/bbl to \$85/bbl (current Brent spot price in excess of \$87/bbl); (iii) an increase in reserve estimates for the prospects within the current exploration campaigns in line with guidance; and (iv) a de-risking from 10% to 30% of the Upper Jurassic intervals in the Licence 61 campaign in light of the outcome yesterday. In terms of our near term forecasts, the additional share count as a result of the Placing counteracts the uplift in our oil price assumption as reflected in revised FY11 adjusted EPS of 9.9c down from 11.1c previously. The de-risking of the Upper Jurassic intervals in Licence 61 and the upward revisions to the combined 2P net reserves for the exploration prospects in Licence 61 (from 41 mmbbls to 69 mmbbls) and in Licence 67 (from 6 mmbbls to 45 mmbbls) materially shifts our Total NAV from 65p to 78p. Aside from exploration driven newsflow anticipated on a quarterly basis, a scheduled trading update at the end of the month should provide detail on production and planned activity on Licence 67. Aligning our price target with Total NAV of 78p, we maintain our Buy recommendation.

Mkt Cap \$339m				
Financial Summary (\$m)				
Year Ending	Dec-09	Dec-10f	Dec-11f	Dec-12f
Sales	0.5	38.3	173.3	301.2
Operating Profit	-3.8	1.3	50.5	96.1
Amortisation	0.0	0.0	0.0	0.0
Other Income	-0.9	-1.4	0.0	0.0
Associates / JV	0.0	0.0	0.0	0.0
Exceptionals	-1.6	-1.2	0.0	0.0
EBIT	-6.3	-1.2	50.5	96.1
Net Interest	0.2	-0.1	1.7	2.8
PBT	-6.2	-1.4	52.2	99.0
Tax	-0.3	0.0	-10.4	-19.8
Attributable Profit	-6.5	-1.3	41.8	79.2
EBITDAe	-4.5	7.2	60.1	109.0
Net Debt	-15.7	-34.5	-49.0	-83.7
Per share Analysis (c)				
Adjusted EPS	-1.9	0.0	9.9	18.7
Operating Cashflow	-1.0	0.5	14.9	25.8
DPS	0.0	0.0	0.0	0.0
Profitability (%)				
Operating Margin	0.0	3.4	29.2	31.9
ROAE	-7.7	-0.2	28.6	35.1
Momentum (%)				
Sales	0.0	7407.7	352.9	73.8
EBITDA	-42.1	-258.2	737.2	81.5
Adjusted EPS	-49.6	-97.4	-19978.1	89.4
Financing				
Debt/Equity (%)	n/m	n/m	n/m	n/m
Interest Cover (x)	n/m	n/m	n/m	n/m
Valuation (x)				
P/E	0.0	91.5	8.0	4.3
Dividend Yield (%)	0.0	0.0	0.0	0.0
EV/EBITDA	-72.7	28.3	5.6	3.0
P/NAV	3.5	4.8	2.9	1.7
Price Performance				
52 Week		Tickers		
High	47.9	Reuters	PTR.L	
Low	13.8	Bloomberg	PTR.LN	
Absolute Price Change (%)		FTSE Oil & Gas Rel.PrcChg		
QTD	59.5	QTD	56.9	
YTD	59.5	YTD	56.9	

PetroNeft Vs FTSE AIM Oil & Gas



PetroNeft - Historic Drilling Results

Well	Date	Net Pay m	Quality °API	Reservoir	Flow Rate bopd
Lineynoye #6	Apr-07	11.2	44	Upper Jurassic	100
Tungolskoye #4	Jun-07	15.0	42	Upper Jurassic	40
Lineynoye #7	Aug-07	2.0	44	Upper Jurassic	125
Korchegskaya #1	Apr-08	3.3	47	Upper Jurassic	125
Lineynoye #8	Jun-08	4.0	44	Upper Jurassic	120
West Korchegskaya #	Sep-08	-	-		
Lineynoye #1	Nov-08	15.4	44	Upper Jurassic	271
Production Well # 109	Jun-10	10.2			
Production Well # 110	Jun-10	8.9			
Production Well # 112	Jun-10	12.0			
Production Well # 112	Jun-10	14.6			
Production Well # 114	Jul-10	15.8			
Production Well # 115	Jul-10	14.0			
Production Well # 116	Aug-10	17.9			
Production Well # 116	Sep-10	10.8			
Production Well # 111	Sep-10	16.0			
Arbuzovskaya #1	Nov-10	5.0	40	Upper Jurassic	289

Source: PetroNeft

PetroNeft Price/Forex Assumptions

	2010	2011	2012
New Oil Price - (\$/barrel)	77.97	85.00	85.00
Old Oil Price - (\$/barrel)	76.36	80.00	80.00
New \$/£ Exchange Rate	1.55	1.54	1.54
Old \$/£ Exchange Rate	1.52	1.42	1.60

Source: Goodbody Stockbrokers

PetroNeft NAV Calculation

	W.I. Reserves mmboe	Risk Weighting	NAV \$m	NAV/Share p	Unrisked \$m	Unrisked p
Risked Development						
<i>Licence 61</i>						
Lineynoye	23.9	70%	119.0	17.7	170.1	29.8
West Lineynoye	23.3	70%	116.2	17.3	166.1	29.1
Tungolskoye	15.5	70%	77.3	11.5	110.5	19.4
Kondrashevskoye	8.1	70%	40.5	6.0	57.8	10.1
(Licence 61) Total			353.1			
Risked Dev NAV	70.8		353.1	52.5	504.4	88.5
Less Net Debt			34.5	5.1		5.1
Total Core NAV (pence)			387.6	57.6		93.6
High Risk Exploration						
<i>Licence 61</i>						
Upper Jurassic	68.5	30%	97.2	14.5	324.1	56.9
Cretaceous	31.2	10%	14.0	2.1	139.7	24.5
Lower-Middle Jurassic	12.6	10%	4.7	0.7	46.9	8.2
<i>Licence 67</i>						
Ledovy	45.0	10%	21.4	3.2	213.5	39.4
High Risk Explor NAV	157.3		137.2	20.4	724.2	129.0
Total NAV			524.8	78.0		222.7

Source: Goodbody Stockbrokers

	Mkt Cap (\$m)		243.45		
	Mkt Cap (£m)		152.16		
PetroNeft					
Financial Overview (\$m)					
Year Ending	Dec-08	Dec-09	Dec10f	Dec11f	Dec12f
Group Sales	0.0	0.5	38.3	173.3	301.2
Cost of Sales	0.0	-0.4	-32.0	-117.1	-199.1
Gross Profit	0.0	0.1	6.3	56.2	102.1
Administration Expenses	-3.6	-3.9	-5.0	-5.7	-6.0
Exploration Write Off	0.0	0.0	0.0	0.0	0.0
EBITDA	-7.8	-4.5	7.2	60.1	109.0
Operating Profit (ex Goodwil	-3.6	-3.8	1.3	50.5	96.1
Goodwill Write-off	0.0	0.0	0.0	0.0	0.0
Other Income	-4.2	-0.9	-1.4	0.0	0.0
Associates / Joint Ventures	0.0	0.0	0.0	0.0	0.0
Exceptional Gain / (Loss)	0.0	-1.6	-1.2	0.0	0.0
EBIT	-7.8	-6.3	-1.2	50.5	96.1
Interest Income / (Expense)	0.1	0.2	-0.1	1.7	2.8
PBT	-7.7	-6.2	-1.4	52.2	99.0
Tax	-0.2	-0.3	0.0	-10.4	-19.8
Minorities	0.0	0.0	0.0	0.0	0.0
Preference Dividends	0.0	0.0	0.0	0.0	0.0
Attributable Profit	-7.9	-6.5	-1.3	41.8	79.2
Net Debt (Cash)	-2.2	-15.7	-34.5	-49.0	-83.7
Shareholders' Funds	45.0	64.2	104.3	146.1	225.3
Enterprise Value	241.3	227.7	208.9	194.4	159.8
<i>Weighted Av Shares (basic)</i>	207.5	255.7	355.6	413.5	413.5
<i>Weighted Av Shares (fully dil.)</i>	207.5	255.7	365.6	423.5	423.5
<i>Year end Shares</i>	207.5	255.7	355.6	413.5	413.5
Per share Analysis (c)					
FRS3 EPS	-3.8	-2.5	-0.4	10.1	19.1
FD EPS	-3.8	-2.5	-0.4	9.9	18.7
Adjusted EPS	-3.8	-1.9	0.0	9.9	18.7
DPS	0.0	0.0	0.0	0.0	0.0
Dividend Cover (x)	n/a	n/a	n/a	n/a	n/a
Operating Cashflow	-1.7	-1.0	0.5	14.9	25.8
Free Cashflow	-11.0	-4.9	-7.0	3.5	8.4
NAV	21.7	25.1	29.3	35.3	54.5
Profitability					
EBITDA Margin	n/m	n/m	18.8%	34.7%	36.2%
EBIT Margin	n/m	n/m	-3.2%	29.2%	31.9%
Effective Tax Rate	-2.7%	-5.2%	3.3%	20.0%	20.0%
Momentum					
Sales	n/m	n/m	n/m	352.9%	73.8%
EBITDA	n/m	n/m	n/m	737.2%	81.5%
Adjusted EPS	n/m	n/m	n/m	n/a	89.4%
DPS	n/a	n/a	n/a	n/a	n/a
Financing					
Debt/Equity (%)	-5.1%	-32.4%	-49.5%	-50.5%	-59.1%
Interest Cover (x)	61.0	29.7	49.9	-35.0	-38.6
Valuation (x) £: 60					
P/E	-25.0	-49.5	-1917.4	9.6	5.1
P/OpCF	-56.7	-99.2	183.4	6.4	3.7
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
EV/Sales	n/m	446.8	5.5	1.1	0.5
EV/EBITDA	-30.8	-50.2	29.1	3.2	1.5
EV/EBIT	-30.8	-36.1	-168.8	3.8	1.7
P/Book	4.4	3.8	3.2	2.7	1.7

PetroNeft

Balance Sheet (\$m)

As at	Dec-08	Dec-09	Dec-10f	Dec-11f	Dec-12f
Tangible Assets	25.6	28.9	52.3	80.9	122.2
Intangible Assets	18.7	18.2	15.8	15.8	16.6
<i>Goodwill</i>	0	0	0	0	0
Financial Assets	0	0	0	0	0
Fixed Assets	44.5	47.3	68.2	96.8	139.0
Debtors	3.1	4.9	2.1	11.9	24.8
Stock	0.0	0.0	4.2	4.2	4.2
Creditors	-3.9	-2.7	-3.2	-14.2	-24.8
Non-Cash Working Capital	-0.8	2.2	3.1	1.8	4.2
Other Liabilities	0.8	1.1	1.6	1.6	1.6
Net Debt	-2.2	-15.7	-34.5	-49.0	-83.7
Preference Shares	0.0	0.0	0.0	0.0	0.0
Minority Interests	0.0	0.0	0.0	0.0	0.0
Shareholders' Funds	45.0	64.2	104.3	146.1	225.3
Total	43.7	49.6	71.4	98.7	143.2

Cashflow Statement (\$m)

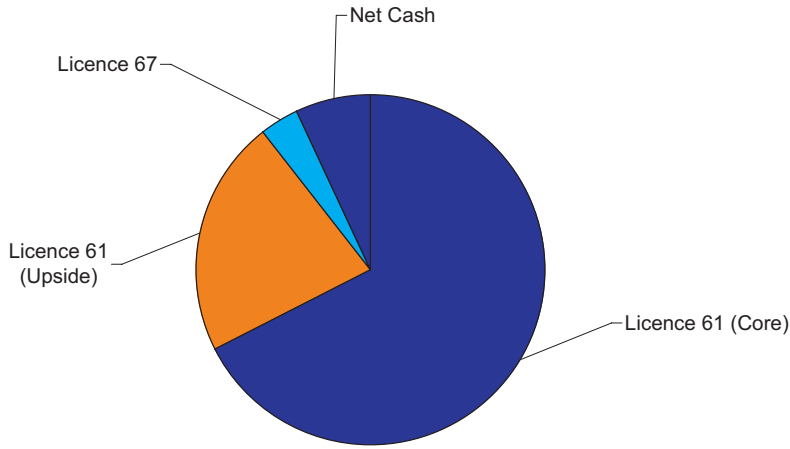
Year End	Dec-08	Dec-09	Dec-10f	Dec-11f	Dec-12f
Operating Profit	-7.8	-4.8	-0.1	50.5	96.1
DD&A	0.2	0.2	7.4	9.6	12.9
Chg in Working Capital	3.4	1.6	-6.8	1.3	-2.4
Other	0.7	0.5	1.4	0.0	0.0
Operating Cashflow	-3.5	-2.5	1.8	61.4	106.7
Net Interest Payable	0.1	0.2	-0.1	1.7	2.8
Dividends Received	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Taxation	0.0	0.0	0.0	-10.4	-19.8
Net Capex	-22.8	-10.3	-26.6	-38.2	-55.0
Other	3.3	0.0	0.0	0.0	0.0
Free Cashflow	-22.8	-12.6	-24.8	14.5	34.7
Acquisitions/Dev Capex	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Issue / Buyback of Shares	17.5	25.9	42.8	0.0	0.0
Currency Translation	0.0	0.0	0.0	0.0	0.0
Other	-0.8	0.3	0.0	0.0	0.0
(Inc)/Dec in Net Debt	-6.1	13.6	18.0	14.5	34.7

PetroNeft Fund Raisings (post IPO)

Date	Shares Issued	Price £p	Proceeds \$m	Application
Sept. 2006	41.5	19.8	15.5	Fund three well campaign
July 2007	15.2	50.0	15.2	Fund three well campaign
Aug. 2008	34.5	25.0	17.3	Pipeline Funding
Sept. 2009	120.6	14.0	27.5	Development Funding
Oct. 2010	63.1	43.0	43.0	Dev/Exp + Acquisitions

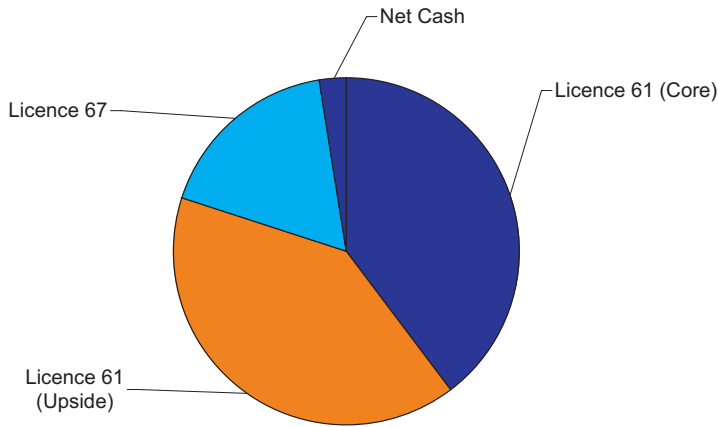
Source: PetroNeft

PetroNeft - Risked NAV



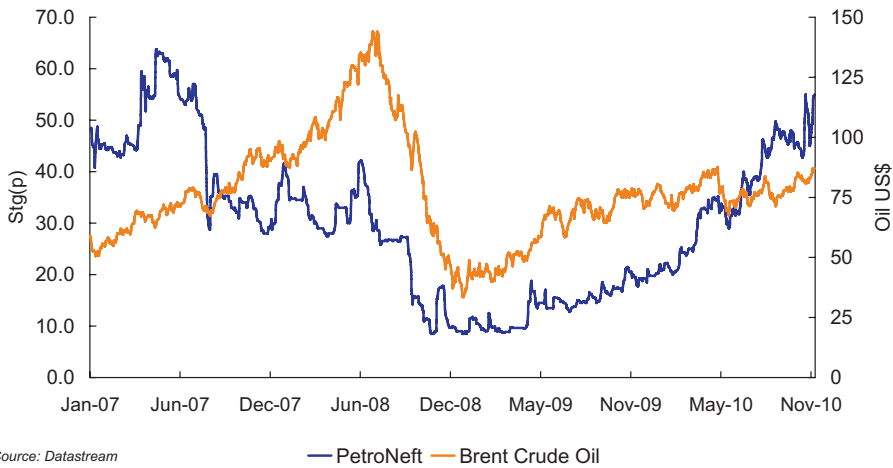
Source: Goodbody

PetroNeft - Unrisked NAV



Source: Goodbody

PetroNeft Vs Brent Crude Oil



Source: Datastream

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Recommendation History

PetroNeft	Current Rec: Buy	Date of first issue: 01/04/2010
	Previous Rec: (if changed in the last year)	Date of first issue:

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