Initiation

Steady progress in the swamp

Investment Case

- Petroneft is focused on the Tomsk Oblast in Western Siberia. It currently has one block, Licence 61 which borders, in part, Imperial Energy’s prospective Block 80.

- The share price currently trades 40% discount to our conservatively-determined core 2P value. This could be further upgraded with successful testing of Tungolskoye field.

- Near term value driving news flow to come from production build up, exploration drilling and probable softening of the tax regime in Russia.

- We initiate with a buy and 60p target, although noting that capital will have to be raised imminently.
Investment Case

Petroneft has steadily built a solid platform from which to grow. Currently undervalued there is upside in the current story.

Petroneft floated in 2006 and has since established net 2P reserves of 60.6mmbbl on a single licence in Western Siberia. Petroneft has 100% of Licence 61, situated in the Tomsk Oblast, to the east of the River Ob. The south eastern edge of its licence adjoins Imperial’s Block 80, on which the Kiev Eganskoye field sits.

It has made steady progress and has fulfilled the majority of its work commitment on Licence 61, the only major objective yet to be fulfilled is full scale production, which we expect to start from the Lineynoye and West Lineynoye fields by mid 2009 and the Tungolskoye field, if testing is satisfactorily completed by 2012.

With an exceptionally experienced management team, with extensive understanding of Russia; the management team was probably one of the first “western” teams into Russia in the 1990s when they were involved with US independent Marathon in securing the Sakhalin II development. However, like all successful regional small oil company models, Petroneft has an extensive Russian management team in place, too.

Petroneft has announced the intention to build a pipeline to export its produced crude into a line to the North of its block and has also acquired a mini-refinery site near Tomsk, with the intention to enter the downstream segment of the Russian oil industry in the medium term. This sector enjoys beneficial tax treatment, relative to pure crude export, as Russia is actively encouraging refinery production so that it can feed growing domestic demand but also export more valuable products.

We conservatively value Petroneft’s 2P reserves at 53p showing that Petroneft currently trades at a discount to its current share price. The taxation regime for oil and gas in Russia is onerous; however, there are positive signs that there will be some relaxation in the tax free allowance in the Mineral Extraction Tax formula from 2009. This will have a positive effect on Petroneft and, by our estimate, if the tax free allowance is moved from $9/bbl to $15/bbl as expected, would uplift the current core value to 60p.

Upside exists within Licence 61, especially in the medium term where the Block adjoins Imperial’s Block 80 where the FTSE 250 Company recently made a major discovery in the Cretaceous Sandstone. In addition we would not be surprised to see Petroneft begin to leverage its Licence 61 track record, plus its exceptional management experience, and obtain further licences in the area. Petroneft will most likely have to raise both equity and debt within the next 6-12 months to achieve its targets in a timely manner.

The stock trades at a discount to our determined core 2P value, and we identify value driving newflow to be generated from field development news on West Lineynoye and Lineynoye, testing results on the proven Tungolskoye field plus exploration news on West Korchegskaya to drive the share price in the near term.

We initiate with a buy and 60p target.
Petroneft

Petroneft has made steady progress on Licence 61 in the Tomsk Oblast. Currently trading below its core 2P value, further value exists.

Petroneft has similarities to Imperial in that it operates 100% of its licence and is focused on the Tomsk region of Western Siberia, indeed they are neighbours on the Eastern bank of the River Ob where Petroneft’s Block 61 sits next to Imperial’s Block 80 immediately to the East.

Petroneft has undertaken a measured work programme on its asset base but has also achieved excellent reserves growth to date, currently standing at 60.6mmbbl of 2P reserve.

Russia
The current situation within Russia has been extensively covered in our research on Imperial Energy, therefore, we see no value for the investor in repeating the findings herein but instead refer the reader to our Imperial coverage.

Petroneft
The Group has its origins in Petroneft LLC which was established in 2003 as an oil and gas investment and consultancy company focussed principally on the Russian market. In May 2005, Petroneft LLC acquired the entire participatory interest in a Russian company, Stimul-T, which had acquired a 100 per cent interest in Licence 61 following a competitive auction process in the November 2004 Tomsk Licence Auction.

Petroneft Resources plc was incorporated on 15 September 2005 and, as part of a corporate reorganisation, acquired the principal assets and liabilities of Petroneft LLC in November 2005. Petroneft listed on AiM in September 2006, raising net funds of approximately £14mn.

Block 61 Licence
The company operates through its Russian subsidiary Stimul-T on the licence. The licence was registered in May 2005 for a period of 25 years and has the following significant obligations, of which it has already met the first two:

- 1,000 km of 2D seismic in first 3 years
- 6 exploration wells to be drilled within 6 years
- Production from Tungolosky to commence within two years of reserves approval by the State body.

In addition, Petroneft is in compliance with all other licence terms as stated in the Ryder Scott CPR of Dec 2007.

Petroneft has net reserves of 60.6mmbbl
Petroneft acquired the Licence 61 assets in 2005 and floated on AiM in 2006.
Petroneft has met all its major licence objectives with the exception of full scale production.
According to the latest Ryder Scott CPR, for the end of 2007, there are three discovered oil fields within Block 61, namely the Lineynoye, Tungolskoye and West Lineynoye.

In addition there were 26 identified prospects, as per the Dec 2007 CPR, which classify under the potential resource category of the SPE reserves classification system. Finally there are currently four potential prospects within the licence area that hold exploration potential as they are inadequately mapped.

Licence 61 is part of the Central West Siberian fold system of Hercynian (Varsican) age and was formed as part of the closure between Laurasia and Gondwana and is similar to the Appalachian trend in North America. The licence sits between, and incorporates within it, three of the major basins in the region.

Within the lease over 30 wells have been drilled historically, targeting mainly Upper Jurassic structures, a total of 14 deep wells have been drilled on seven of the structures.

**Figure 1: Petroneft Block 61 Location**

Reserves are based on 3 discovered fields. In addition there are 26 identified and mapped prospects.
There are currently five identified oil and gas bearing sequences within the Tomsk region, an intra-Paleozoic sequence, a sequence between Paleozoic and Mesozoic, lower-middle Jurassic, Upper Jurassic and Cretaceous. The Upper Jurassic is the major sequence on which the majority of exploration and production activity takes place in the region.
Table 1: Exploration Sequences

<table>
<thead>
<tr>
<th>Sequence</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paleozoic-Mesozoic</td>
<td>9 wells drilled with minor oil shows</td>
</tr>
<tr>
<td>Lower Middle Jurassic</td>
<td>unknown and untested but shows seen in two wells</td>
</tr>
<tr>
<td>Upper Jurassic</td>
<td>Extensive discoveries including Lineynoye and Tungoleskoye fields</td>
</tr>
<tr>
<td>Cretaceous</td>
<td>Not yet known</td>
</tr>
</tbody>
</table>

Source: Daniel Stewart after Ryder Scott CPR

Reservoir Details

The reservoir properties of the Lineynoye and Tungoleskoye fields, as per the CPR are:

Table 2: Reservoir Properties

<table>
<thead>
<tr>
<th>Property</th>
<th>Lineynoye and West Lineynoye</th>
<th>Tungoleskoye</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depth top Reservoir – m</td>
<td>a.e. -2,393 m and -2,395 m</td>
<td>a.e. -2,503.3 m</td>
</tr>
<tr>
<td>Porosity</td>
<td>14.0 to 17.4 %</td>
<td>14.4 to 17.7 %</td>
</tr>
<tr>
<td>Permeability – mD</td>
<td>&lt; 2.0 to 38.5 mD</td>
<td>&lt; 2.0 to 43.4 mD</td>
</tr>
<tr>
<td>Net Pay thickness – m</td>
<td>1.5 to 15.4 m</td>
<td>12.9 to 15.2 m</td>
</tr>
<tr>
<td>Hydrocarbon Saturation</td>
<td>63 to 80 %</td>
<td>49 to 63 %</td>
</tr>
<tr>
<td>Formation pressure – psia</td>
<td>3,777 psia</td>
<td>3,850 psia</td>
</tr>
<tr>
<td>Formation temperature - º</td>
<td>93 ºC</td>
<td>98 ºC</td>
</tr>
<tr>
<td>API gravity of crude oil</td>
<td>38 to 44 degree API</td>
<td>40 degree API</td>
</tr>
</tbody>
</table>

Source: Petroneft/Ryder Scott

Recoveries are estimated at around 25% of the oil in place, which is typical for this region.

Work progress to date

West Lineynoye and Lineynoye Field

These fields are located in the north-west of licence 61, the Lineynoye structure being identified in 1968 and subsequently drilled and discovered in 1972

Figure 4: Lineynoye Field Map

Tight reservoirs are typical in this region

Source: Petroneft
The discovery well identified the reservoir around 2,500m subsurface and tested light oil at 38 degree API at 42 cubic meters/day, although no oil water contact was found within the well. Subsequent to this, a further five wells were drilled up to 1974, however all were predominantly water saturated, with the exception of the fifth, which had minor oil shows.

During 2005/06 Petroneft reprocessed the vintage seismic data on the field and also acquired 515km of high resolution modern seismic. As a result of this work it became apparent the field was actually two separate structures, the first well identifying the Lineynoye oil field and the 5th Soviet well clipping the edge of the Western Lineynoye field.

Petroneft drilled the No.6 well in 2007 as a twin of the original discovery well confirming two intervals in the J1 sandstone target. The oil water contact was found to be 10m lower than previously determined and on test the well flowed at 100bopd on a 3mm choke. Subsequent to this, Petroneft drilled well No. 7 confirming the West Lineynoye Field, testing of the J1 sandstone target yielded 125bopd from one horizon.

Submersible electric pumps have been installed on both 6 and 7 and are undergoing pilot production studies currently. The No.7 well, on the West Lineynoye field, produced at stabilised rates of 85 bopd with pump problems and the No. 6 well test produced at a steady 245 bopd. The results from this well will allow fracture geometry to be determined and ultimately the field production plan.

The Lineynoye No.8 delineation well was scheduled to commence in May and results are expected shortly.

**Our Opinion – Lineynoye**

With the testing completed on both fields the field development plan should be in the process of being compiled and completed for approval. These fields represent the earliest opportunity for cash flow in the current Petroneft portfolio.

As with Imperial, the correct field development strategy, especially fracture and sand control strategies, will be key to sustainable production from the fields.

Further funds will be required to speedily develop the cash flow potential in these fields, as such we envisage debt and equity raisings to be undertaken in 2008/09, especially to fund the pipeline development.

---

Two fields have been identified

Lineynoye fields offer near term cash flow

Correct fracture geometry is essential for sustainable production from West Siberian fields.
The Tungolskoye field lies in the centre of the licence and was initially delineated in 1968 and 1971 and was drilled in 1973. Well No.1 was drilled on the crestal high to a depth of 2,760m, tested at 2,426m and flowed 12.7 cubic meters per day of 40 degree API oil.

As with the Lineynoye fields, Petroneft reprocessed the vintage seismic and undertook over 500km of high resolution 2D seismic between 2005 and 2007. In 2007 the Tungolskoye No.4 well was drilled and penetrated 15m of continuous oil saturated sandstone in the target J1 reservoir.

Mechanical problems were encountered during the testing of this well and subsequent to this the rig was demobilised and moved to undertake exploration drilling on the West Korchegskaya prospect.

The intention was to bring in a truck mounted unit in March 08 to undertake the testing operations; however no RNS updates have been issued on the progress of this testing.

Our Opinion – Tungolskoye

The lack of modern testing on this field does present an unknown at this stage, and although oil has been proved and recovered we are slightly more conservative of the prospects than Lineynoye. As such we assume a 12% discount factor in our model until testing results have been announced.

West Korchegskaya Exploration

The principal target horizons for this well are Upper Jurassic sandstone reservoirs, at an expected depth of 2,450 metres. According to the CPR the prospect has an estimated 36mbbl of possible reserves.

Tungolskoye testing has been delayed due to the movement of the rig. We await newsflow on the work over rigs status.
Operations are still ongoing on this well which spudded in March and was estimated to take 65 days to reach target depth. However, news was leaked in the regional press in mid April that moveable oil had been identified in the target interval.

Our Opinion – West Korchegskaya

With no attributable 2P reserves yet we don’t attach a value at present. However, it has clearly been shown that oil is present in the target and what remains to be shown is that it can be commercially extracted.

This clearly shows the prospectivity that lies within the Licence 61 area and highlight that additional upside exists within the further prospects within the licence area.

Further Upside - Significance of Imperial’s Block 80 discovery to Petroneft

According to the Ryder Scott CPR the oil and gas presence in the Cretaceous - Neocomian deposits within License 61 limits is not yet known. Three wells have historically tested this sequence within the Lineynoye area, the Sibkrayevskaya area and in Emtorskaya area and all found to be water bearing.

These wells were all in the north of Block 61 and hence the recent Imperial announcement on its neighbouring Block80 field Kiev-Eganskoye is particularly relevant to this interval for Petroneft, further south in licence 61, reinforced by the CPR commenting that the Traverskaya prospect is highlighted as a potential extension to the Imperial field.

The particularly interesting feature of Imperial’s Cretaceous discovery is the free flowing nature of the well, reported at 1,500 bopd. This is something almost unheard of in the Tomsk region, where fracturing is an almost exclusive undertaking to achieve production.

We understand Traverskaya is not an immediate target for Petroneft, and the progress of Imperial will be examined prior to an exploration well being undertaken here. It is also noteworthy, that given the potential interconnectivity between the Traverskaya and Kiev-Eganskoye fields, some form of unitisation may be necessary in the future.

Acquisition of Refinery Site

Petroneft has a medium term strategy to participate in both the upstream and downstream segments of the oil and gas business in Russia, to this end, Petroneft announced, in early 2008, that it has acquired a site for a Mini-Refinery. The site is at Pervomayka in the Kolpashevo District of the Tomsk Oblast, south of the Company’s current operational area in Licence 61. The 7.5 hectare site is located approximately 200 km northwest of the city of Tomsk at the Transneft pipeline Pervomayka pumping station in the Kolpashevo District.

The Regional Administration has given permission for the use of the land for a Mini-Oil-Refinery and some site clearance and preliminary ground works were carried out by the previous owner and the off-take flange for the Transneft pipeline connection is already in place.

Our opinion - Refinery

We give no value for this interesting development at present. However, we recognise the potential for the production of refined product within Russia is subject to generous tax breaks as the country looks to leverage its oil and gas wealth into even more valuable refined products.

We await further developments on this downstream venture in due course.
In mid December 2007, Petroneft’s subsidiary, Stimul-T signed a protocol of intent with OAO Bashneft, the operator of two Licences with producing fields in the Khanty-Mansiysk Oblast located immediately northwest of PetroNeft’s Licence 61. This agreement will enable PetroNeft to tie-in to the Bashneft pipeline at the Lukpaiskaya pumping station under a simplified custody transfer scheme.

The Lukpaiskaya pumping station is located only 60 km from the Lineynoye and West Lineynoye Oil Fields. This is an optimal route as the pipeline crosses flat terrain, without major river crossings, thereby minimising the capital costs to Petroneft. In addition, with the pipeline heading North, Petroneft has the preferable option of being able to develop the northern fields on its licence first.

Bashneft will then transport the crude to the Aleksandrovskoye custody transfer station where it will enter the Transneft pipeline for export outside of Russia or for domestic sales.

The pipeline is expected to transport full scale production from Licence 61 in 2009.

**Licence 61 Reserves**

The Approved Russian State Reserves for Licence 61 are as follows:

<table>
<thead>
<tr>
<th>Produced</th>
<th>Discovered Resources A+B+C1</th>
<th>Undiscovered Resources C2</th>
<th>C3</th>
<th>D1</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil (mmbbl)</td>
<td>0</td>
<td>22.11</td>
<td>2.14</td>
<td>35.41</td>
<td>152.51</td>
</tr>
<tr>
<td>Gas (bcf)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>26.09</td>
<td>26.09</td>
</tr>
<tr>
<td>Total (mmbboe)</td>
<td>0</td>
<td>22.11</td>
<td>2.14</td>
<td>35.41</td>
<td>157.9</td>
</tr>
</tbody>
</table>

Source: Ruder Scott
Updated Russian reserves were due to be completed in March; however no announcement has been made to this effect as yet.

### Table 4: SPE Reserves (mmbbl)

<table>
<thead>
<tr>
<th>Field</th>
<th>1P</th>
<th>2P</th>
<th>3P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lineynoye</td>
<td>4.2</td>
<td>16.3</td>
<td>22.7</td>
</tr>
<tr>
<td>West Lineynoye</td>
<td>0.9</td>
<td>28.8</td>
<td>44.4</td>
</tr>
<tr>
<td>Tungol'skoye</td>
<td>1.5</td>
<td>15.5</td>
<td>22.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6.6</td>
<td>60.6</td>
<td>89.9</td>
</tr>
</tbody>
</table>

Source: Petroneft/Ryder Scott

Future key fields for development are the Korchegskaya, Varyakhskaya and Sibkraevskaya fields.

### Management

#### Directors

**David Golder, Non-Executive Chairman**

Mr Golder has over 36 years of experience in the petroleum industry and most recently was Senior Vice President of Marathon Oil Company ("Marathon") until his retirement in 2003.

**Dennis Francis, Chief Executive Officer**

Dennis has over 35 years of experience in the petroleum industry and was with Marathon Oil Company for 30 years, where he started work with Marathon as a geologist/geophysicist and held various international positions.

In 1990, Mr Francis became USSR/FSU task force manager responsible for establishing a special task force to develop new opportunities for Marathon in Russia. Marathon and its partners ultimately won the first Russian competitive tender, which was to develop the Sakhalin II Project offshore Sakhalin Island.

Mr Francis is a member of the American Association of Petroleum Geologists and Society of Exploration Geophysicists. He has a BSc degree in geophysical engineering and a MSc degree in geology both from the Colorado School of Mines and has completed the Program for Management Development at Harvard University.

**Paul Dowling, Finance Director**

Paul joined the Company on 1 October 2007 and was appointed to the Board of Directors on 29 April 2008. He has 17 years experience in the areas of banking, accounting, auditing, taxation, financial reporting, AIM/IPO reporting, corporate restructuring, corporate finance and acquisitions/disposals.

Most recently he was a Partner in the firm LHM Casey McGrath located in Dublin. Mr. Dowling has worked in a number of industries and has significant experience in the Natural Resources sector. He is a fellow of the Association of Chartered Certified Accountants (ACCA) and a member of the Irish Taxation Institute. He currently represents the ACCA with the Consultative Committee of Accountancy Bodies - Ireland (CCAB-I).

**Dr David Sanders, Vice President and General Legal Counsel**

Dr Sanders is an attorney of law and has over 30 years of experience in the petroleum industry, including 15 years of doing business in Russia. In 1988, Dr Sanders joined Marathon Oil Company where he analysed and reviewed joint
venture agreements for worldwide production until his assignment in 1991 to the negotiating team for the Sakhalin II Project in Russia. In 1994, he was seconded for one year as an attorney to Sakhalin Energy Investment Company in Moscow.

He then provided commercial guidelines and transactional analysis of numerous Russian projects to Marathon’s CIS Joint Ventures Group and later became the lead negotiator for Russian projects in Marathon’s Business Development-Commercial & Negotiations Group.

Dr Sanders has a degree in electronics from Pennsylvania Institute of Technology, a liberal arts degree from the University of Houston and a doctorate of jurisprudence from South Texas College of Law. He is a member of the State Bar of Texas and of the American Bar Association.

Thomas Hickey, Non-Executive Director

Mr Hickey is a chartered accountant and has been Chief Financial Officer and a director of Tullow Oil plc since 2000. Prior to joining Tullow Oil plc he was an Associate Director of ABN AMRO Corporate Finance (Ireland) Limited, which he joined in 1995. In this role, he advised public and private companies in a wide range of industry sectors in relation to fund raising, stock exchange requirements, mergers and acquisitions, flotations and related transactions. Mr. Hickey has a degree in Commerce from the University College Dublin and is a Fellow of the Institute of Chartered Accountants in Ireland.

Vakha A. Sobraliev, Non-Executive Director

Mr Sobraliev has over 30 years of experience operating and managing energy service companies and state operating units exploring for and exploiting oil resources in the Western Siberian Oil and Gas Basin. Mr Sobraliev is currently a shareholder and General Director of Tomskburneftegaz, LLC an oil and gas well drilling and services company operating in Western Siberia. This company owns over 15 exploration and production drilling rigs and associated support equipment and mechanical repair facilities.

Senior Management

Alexey Balyasnikov, General Director of Stimul-T

Mr Balyasnikov has over 32 years of experience in the Russian oil and gas industry. He worked for Marathon in various capacities, including as head of Marathon’s representative office in Moscow, from 1990 to 2004. Prior to joining Marathon, Mr Balyasnikov was a senior geophysical researcher for the Moscow Research Institute. Mr Balyasnikov has a degree in geophysics from St. Petersburg University. He is a native Russian speaker who is fluent in English.

Alexander Frenovsky, Executive Director of Stimul-T

Mr Frenovsky has over 34 years’ experience in the oil industry, and is a former general director and chief engineer of JSC Tomskneftegazgeologia, the former Russian state enterprise that discovered and delineated the oil and gas fields in the Tomsk Region.

Dr Nikolay Karapuzov, Chief Geologist and Geophysicist of Stimul-T

Dr Karapuzov was chief geophysicist/chief geologist of JSC Tomskneftegazgeologia, where he worked for 35 years and directly participated in the discovery of 17 oil fields in the area.
Valuation

We have undertaken a tax/royalty model of the Petroneft assets on which 2P reserves are currently declared.

We have assumed the following in our analysis:

- West Lineynoye and Lineynoye fields start production mid 2009
- Tungolskoye starts production 2012
- Mineral extraction tax based of $16.32/bbl for $80/bbl Urals export price
- Corporation tax of 24%
- We assume 15% of Petroneft's oil is for export, the balance for domestic consumption. This results in an average sales price of $42/bbl based on a Urals price of $80 and takes into account VAT.
- Opex, escalating at 2.5% of $4/bbl. Capex of around $5-6/bbl per field
- Discount rate of 10%, 12% for Tungolskoye

**Core 2P Value**

The following is our assessment of the core 2P value for Petroneft.

**Table 5: Core 2P valuation**

<table>
<thead>
<tr>
<th>Net Reserves</th>
<th>In Ground Price</th>
<th>PV(10)</th>
<th>pence/share</th>
</tr>
</thead>
<tbody>
<tr>
<td>mmbboe</td>
<td>$/boe</td>
<td>£m</td>
<td></td>
</tr>
<tr>
<td>Lineynoye</td>
<td>14.53</td>
<td>$4.59/bbl</td>
<td>£33mn</td>
</tr>
<tr>
<td>Lineynoye West</td>
<td>27.36</td>
<td>$3.3/bbl</td>
<td>£45mn</td>
</tr>
<tr>
<td>Tungolskoye (12% discount)</td>
<td>14.70</td>
<td>$3.28/bbl</td>
<td>£24mn</td>
</tr>
<tr>
<td>Totals</td>
<td></td>
<td>£103mn</td>
<td>53p</td>
</tr>
</tbody>
</table>

Source: Daniel Stewart

As such, Petroneft currently trades at a 40% discount to its core 2P value. However we note that capital will have to be raised to complete its 2008 work programme.

Of note are the Herold/Lovegrove 2007 M&A numbers for Russian 1P and 2P which stood at $4/boe and $1.50/boe respectively, which compare favourably to our calculated figures.

**Beyond Licence 61**

Petroneft has adopted a very safe business strategy over the last few years and has shown it can effectively explore and develop reserves on its licence. It has not ventured outside its licence, but we feel, given the excellent progress it has made on Licence 61 plus the restrictions that will occur in bringing multiple fields on in a limited area may bring, that a prudent move for Petroneft would be to start on the acquisition trial within the region.

In this respect it is worth highlighting the extensive Russian experience of the directors and operations team and feel that any expansion could be easily achieved.
**Taxation changes**

Whilst it would appear the political system and the bureaucracy within Russia will not be changing anytime soon, it is interesting to note that terms for investment in the oil and gas sector could be changing.

Putin announced in his maiden speech to the State Duma in May that he intends to reward oil companies which invest in new oilfield development with tax relief, and balance-sheet incentives.

Of greater interest to Petroneft however are the proposed changes to the Mineral Extraction Tax, currently defined as 420 roubles per tonne multiplied by a coefficient derived as

$$R = \frac{(\text{Urals \ Price} - \$9/\text{bbl}) \times \text{USD: RUB}}{261}$$

At an $80/bbl Urals price and a 23.88 USD: RUB exchange rate the Mineral Extraction Tax equates to 2730.5 roubles/ton or $16.32/bbl.

The tax change is expected to add an additional amount to the tax free allowance, currently $9/bbl. Whilst this amount has not been confirmed or approved it is strongly rumoured to be increased to $15/bbl. On this basis the MET decreases 23 cents/barrel for every dollar added to the allowance, such that a $15/bbl allowance equates to an MET of $14.94/bbl.

From this, we are of the opinion, that the Russian authorities are recognising the need for a more lenient tax regime, which can only favour Imperial as it increases production.

The affect on the current core value of Petroneft, in this instance, would represent a 13% uplift from the current 53p to 60p.

**Value Adding Newsflow**

- West Korchegskaya – exploration well update
- Tungolskoye – Testing update
- Debt/Equity raising
- Pipeline construction progress
- Potential acquisition of further acreage (longer term news)

**Target Price**

Considering the core 2P value, the potential tax change, the upside within licence 61 plus the highly Russian experienced management team we initiate on Petroneft with a 60p target.

Muted taxation changes will be positive for oil players in the region.

Although we recognise that capital has to be raised we see the assets, management and newsflow as a good investment.
Disclosure Checklist

<table>
<thead>
<tr>
<th>Company</th>
<th>Code</th>
<th>Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Petroneft Resources</td>
<td>PTR</td>
<td>3</td>
</tr>
<tr>
<td>Imperial Energy</td>
<td>IEC</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Daniel Stewart

1. Within the past twelve months Daniel Stewart & Co plc and/or its affiliates has managed or co-managed a public offering for this Company, for which it received fees or the promise of fees.
2. Daniel Stewart & Co plc and/or its affiliates act as corporate broker or nominated advisor to this Company.
3. Daniel Stewart & Co plc and/or its affiliates regularly hold/may hold in future trading positions (which may include options) in this Company.
4. Daniel Stewart & Co plc and/or its affiliates holds more than 5% of the securities of this Company.
5. The Company holds more than 5% of the securities of Daniel Stewart & Co plc and/or its affiliates.
6. Daniel Stewart & Co plc and/or its affiliates may currently be providing, expects to provide within the next three months or may have provided within the previous twelve months, investment banking services to this Company, which have given rise to payment or the promise of payment.
7. The author and/or an individual responsible for production of this report has direct ownership of stock in this Company.
8. The author responsible for the production of this report received or purchased shares in the issuer, prior to a public offering of the shares.
9. Daniel Stewart and Company is party to an agreement with this company for the publication of research on it.
10. This research note has been disclosed to the Company, with resulting amendments, prior to its dissemination.

The Daniel Stewart recommendation structure is based on relative upside/downside to target price. The target price is set on a rolling 12 month view. Upside or downside of 10% or more is categorised as Buy or Sell respectively, and less than 10% a Hold.

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Distribution of Ratings

<table>
<thead>
<tr>
<th></th>
<th>All Companies</th>
<th>Of which are Investment Banking Clients in the last 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>72%</td>
<td>40%</td>
</tr>
<tr>
<td>Hold</td>
<td>20%</td>
<td>9%</td>
</tr>
<tr>
<td>Sell</td>
<td>8%</td>
<td>0%</td>
</tr>
</tbody>
</table>

data as of 31 March 2008

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Authorised and Regulated by the Financial Services Authority.  April08
Key Assumptions

- Conservative assumptions on oil price
- First production mid 2009

<table>
<thead>
<tr>
<th>Income</th>
<th>08/06A</th>
<th>08/07E</th>
<th>08/08E</th>
<th>08/09E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>18.5</td>
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<tr>
<td>Gross Profit</td>
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<td>0.0</td>
<td>0.0</td>
<td>2.3</td>
</tr>
<tr>
<td>EBITDA (DSC)</td>
<td>(1.0)</td>
<td>(2.2)</td>
<td>(2.4)</td>
<td>(3.0)</td>
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<tr>
<td>Profit (DSC)</td>
<td>(1.0)</td>
<td>(3.2)</td>
<td>(3.3)</td>
<td>(7.9)</td>
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<tr>
<td>EPS (DSC)</td>
<td>(0.4)</td>
<td>(0.9)</td>
<td>(0.9)</td>
<td>(2.1)</td>
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</table>

<table>
<thead>
<tr>
<th>Cash Flows (£m)</th>
<th>08/06A</th>
<th>08/07E</th>
<th>08/08E</th>
<th>08/09E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Op. CF (£m)</td>
<td>(1.2)</td>
<td>(0.5)</td>
<td>(1.2)</td>
<td>(0.6)</td>
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<tr>
<td>Gross CF (£m)</td>
<td>12.6</td>
<td>(12.8)</td>
<td>(28.9)</td>
<td>(54.4)</td>
</tr>
<tr>
<td>FCF (£m)</td>
<td>(9.6)</td>
<td>(12.8)</td>
<td>(28.9)</td>
<td>(54.4)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Balance Sheet (£m)</th>
<th>08/06A</th>
<th>08/07E</th>
<th>08/08E</th>
<th>08/09E</th>
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<tbody>
<tr>
<td>Fixed Assets</td>
<td>14.6</td>
<td>26.9</td>
<td>53.9</td>
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<td>Current Assets</td>
<td>12.9</td>
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<td>(28.8)</td>
<td>(83.2)</td>
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<tr>
<td>Current Liabilities</td>
<td>0.4</td>
<td>0.9</td>
<td>1.4</td>
<td>1.9</td>
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<tr>
<td>Net Assets</td>
<td>27.1</td>
<td>26.0</td>
<td>23.6</td>
<td>16.6</td>
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<tr>
<td>Net Debt (Cash)</td>
<td>12.9</td>
<td>0.0</td>
<td>(28.8)</td>
<td>(83.2)</td>
</tr>
</tbody>
</table>

Recent News / Events

Operations update

Management Team

- D Golder – NEC
- D Francis – CEO
- P Dowling – FD
- T Hickey - NED

Major Shareholders

- RAB Octane Fund: 19.6%
- Davycrest Nominees: 17.1%
- V Sobraliev: 12.0%
- D Francis: 10.6%
- Vidacos Nominees: 6.2%
- JP Morgan AM: 3.9%