Goodbody STOCKBROKERS

Ireland

PetroNeft

Oil & Gas

About to Turn on the Tap

Closing Price: £0.31

Price Target: £0.65

BUY

- **Historical Backdrop.** Established in 2003, PetroNeft acquired 100% of a licence in Tomsk, Western Siberia, and commenced an appraisal programme in 2007 aimed at justifying field development. Six wells in 2007 & 2008 saw the 2P reserve estimate rise steadily from 33.5 mmbo to 70.0 mmbo, with gross reserves (3P) increasing from 324.2 mmbo to 529.4 mmbo. Despite the solid execution, the collapse in oil prices and a dearth of funding forced a decision in Q4 2008 to defer field development for a year. While that weighed heavily on the share price, the decision, in retrospect, proved beneficial in that capex associated with the distribution pipeline and facilities subsequently reduced considerably from $60m to $25m. The requisite funds were secured in a placing in September 2009, establishing a start date for production of Q3 this year.

- **Market Approach.** Market approach has been specific to Russia. Armed with a knowledge of the region, the aim was to exploit past survey inefficiencies and subsequent advances in seismic and drilling techniques to build a sustainable asset base. Prospects that historically were too small to develop during the original exploration phase in the '70s form the target asset base for PetroNeft

- **Self funded**. Despite a stated preference to fund development through a mixture of debt and equity, market conditions to date have mandated the latter. That said, with PetroNeft due to generate positive net cashflow in 2011 and no debt, achieving the target Q3 production start date will clearly have a profound impact on the model in that it moves PetroNeft firmly into the self-funded realm. Additional equity will likely now only arise, in our view, to fund a large acquisition. We estimate net cash by year end of $2.4m, rising to $10.5m by the end of the following year.

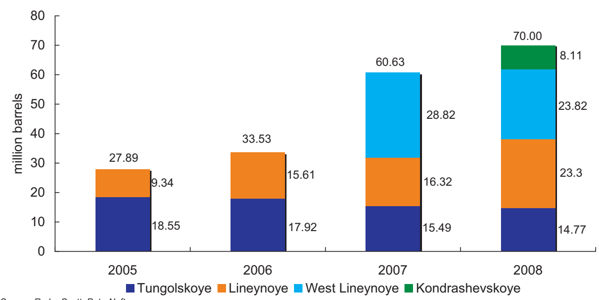
- **Recommendation.** Despite regional and market challenges, PetroNeft would appear to be on the cusp of production. That transition will provide funds to secure additional acreage and thus enable management to repeat the cycle based on a proven track record. Valuation, both on an absolute (Core NAV of 58.3p, Total NAV of 64.6p), and relative basis (EV/2P boe of $1.3 v a peer group average of $3.4), underpins the investment case, with the former providing the basis for our price target of 65p. We initiate coverage with a Buy recommendation.

Mkt Cap $167m

Financial Summary ($m)				
Year Ending	**Dec-08**	**Dec-09f**	**Dec-10f**	**Dec-11f**
Sales	0.0	2.1	49.1	172.3
Operating Profit	**-4.8**	**-2.9**	**5.7**	**48.4**
Amortisation	0.0	0.0	0.0	0.0
Other Income	-3.0	0.0	0.0	0.0
Associates / JV	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0
EBIT	**-7.8**	**-2.9**	**5.7**	**48.4**
Net Interest	0.1	0.0	0.5	0.3
PBT	**-7.7**	**-2.9**	**6.2**	**48.7**
Tax	-0.2	-0.2	-1.1	-9.7
Attributable Profit	**-7.9**	**-3.1**	**5.0**	**39.0**
EBITDAe	-7.8	-2.9	13.0	58.0
Net Debt	-2.2	-17.7	-2.4	-10.5
Per share Analysis (c)				
Adjusted EPS	-3.8	-0.9	1.4	10.8
Operating Cashflow	-5.2	-0.2	3.4	15.9
DPS	0.0	0.0	0.0	0.0
Profitability (%)				
Operating Margin	0.0	0.0	11.7	28.1
ROAE	-17.6	-4.7	7.1	35.3
Momentum (%)				
Sales	0.0	0.0	2268.4	251.0
EBITDA	129.3	-63.3	-551.9	345.6
Adjusted EPS	118.6	-77.5	-263.3	672.7
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	0.0	34.1	4.4
Dividend Yield (%)	0.0	0.0	0.0	0.0
EV/EBITDA	0.0	-54.8	12.1	2.8
P/NAV	2.2	2.5	2.3	1.5

Price Performance			
52 Week		**Tickers**	
High	47.9	Reuters	PTR.L
Low	13.8	Bloomberg	PTR LN
Absolute Price Change (%)		**FTSE Oil & Gas Rel.PrcCha**	
QTD	59.5	QTD	56.9
YTD	59.5	YTD	56.9

PetroNeft: 2P Reserve Progression



Source: Ryder Scott, PetroNeft

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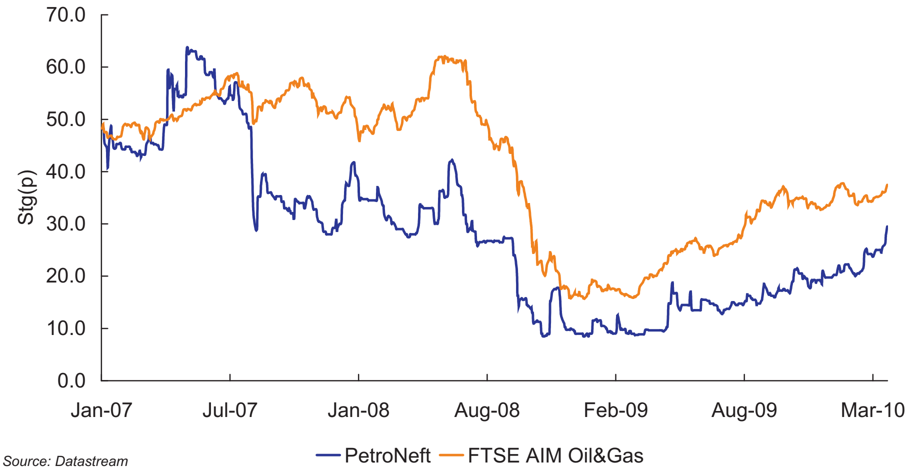
Historical Context

Volatility in commodity markets reflected in PetroNeft's share price performance

PetroNeft's relatively short history as a publicly listed entity has not been without incident, nor is it a reflection of the depth of management experience. Indeed, the latter is in marked contrast to the relative immaturity of PetroNeft as a publicly-listed company. The timing of PetroNeft's public unveiling pre-dated the surge in oil prices, resultant market speculation in resource stocks and subsequent commodity capitulation that marked the period 2007 to early 2009. Along the way, PetroNeft saw its share price ride the wave from an initial public offering in September 2006 at 19.8p to a height of 63p in June the following year, before falling to a level of 10p at the trough in oil prices in Q1 2009. Exacerbating the deflationary impact on commodity prices as a result of the property induced economic downturn was an abrupt cut off of credit to small E&Ps, which forced PetroNeft to delay plans for the development of its then sole licence by a year. In hindsight, the decision to defer development was beneficial in that it enabled management to: (i) conserve capital; (ii) consolidate its position in the region of interest; and (iii) avail of reductions in development and distribution costs as the operating environment re-adjusted to the new pricing reality.

PetroNeft Vs FTSE AIM Oil & Gas rebased



Source: Datastream

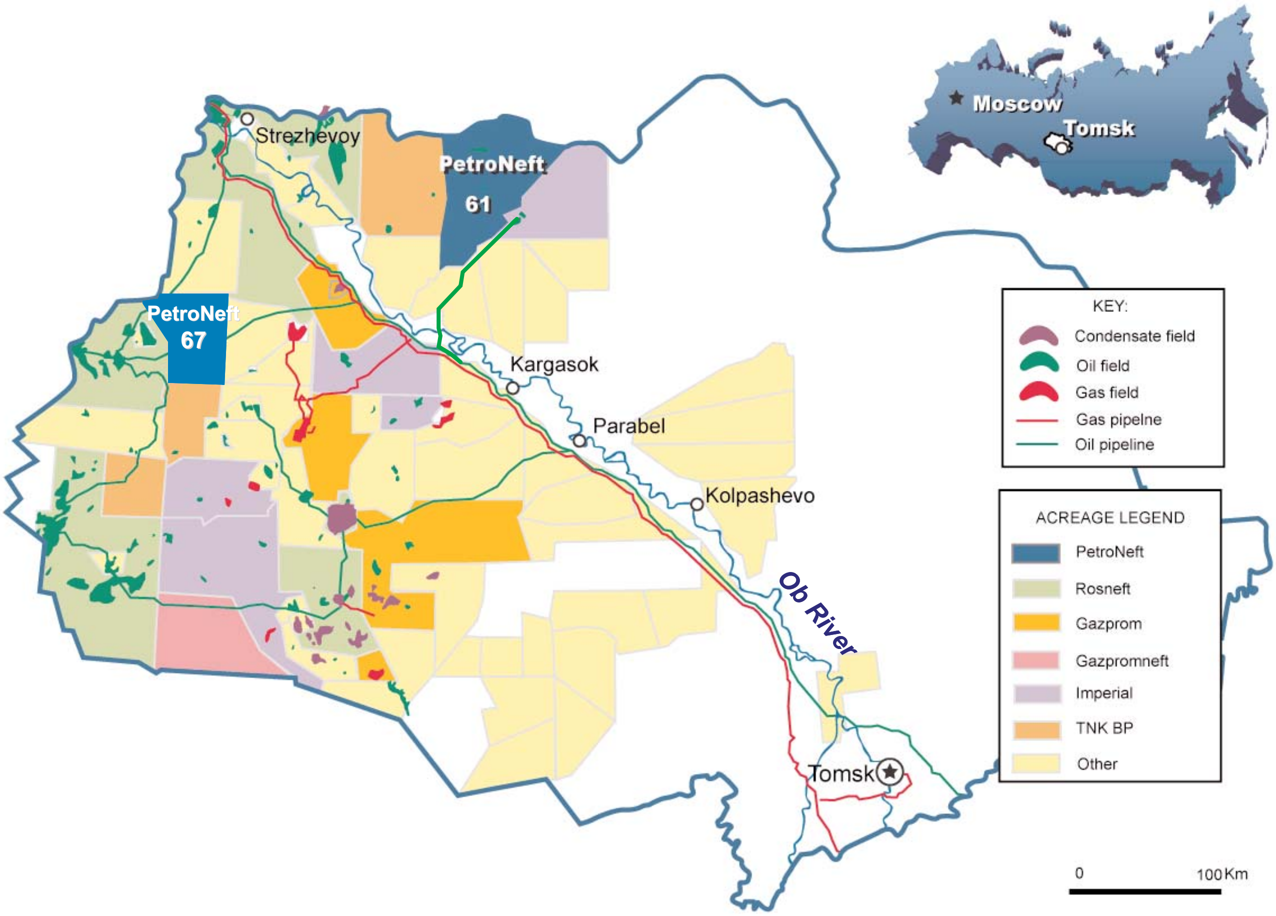
Region of interest is Tomsk in Western Siberia

The region of interest to PetroNeft is Western Siberia and specifically two licences on either side of the Ob River in the Tomsk region of Siberia. From a development perspective Tomsk is relatively mature, particularly on the western side of the river where several indigenous Russian (Gazprom, Rosneft, and Gazpromneft) and international (TNK BP, Imperial / ONGC) companies currently produce. The root of PetroNeft's involvement resides in the experience of senior management (Appendix I), specifically that of CEO, Dennis Francis and his past role as Head of Marathon Oil's Business Development Activities in Russia from 1989 to 2003. The knowledge gained, and relationships built, during that period sowed the seeds for PetroNeft.

Access to Tomsk acreage was gained through the acquisition of Stimul-T, the 100% owner of Licence 61

Established in 2003, the company, which at the time was largely a consultancy focused on the Russian oil & gas market acquired a local Russian company, Stimul-T (Appendix II) in 2005. It held 100% of Licence 61 following the November 2004 Tomsk Licencing Round. At the time, the attractions of the Licence were that it included a couple of known discoveries (Lineynoye and Tungolskoye), which according to Ryder Scott held a 2P reserve base of 28 mmbo with a gross upside (3P) of 291 mmbo and a further 100 mmbo in exploration potential. The downsides were: (i) the tight reservoir characteristics synonymous with the region; (ii) the relative remoteness of the licence; (iii) the lack of infrastructure on the eastern side of the Ob; and (iv) an operating environment that precluded drilling activity to the winter months. The initial objective was to prove up the resource base to justify development, with the funds secured in the Sept. 2006 listing on AIM and the IEX targeted at an appraisal campaign aimed at achieving that objective.

IPO objective to prove up the Tomsk resource base



Tomsk forms part of the West Siberian oil and gas basin, reputedly the largest in the world in terms of size and the next largest to the Middle East in terms of reserves (144bn barrels and 1,300 TCF of discovered oil and gas reserves). Despite that, parts of the region remain under explored for reasons that largely relate to past exploration activity and environment. Terrain (low lying swamp land), weather (winter temperatures falling to -40° C) and the lack of infrastructure (roads, pipelines and power) provide obvious challenges. The latter is particularly the case on the eastern side of the Ob river, the location of Licence 61, where until recently the distance to the nearest pipeline was 60km and the nearest paved road 90km away. Licence requirements mandated:

Opportunity arises as parts of the region are under-explored

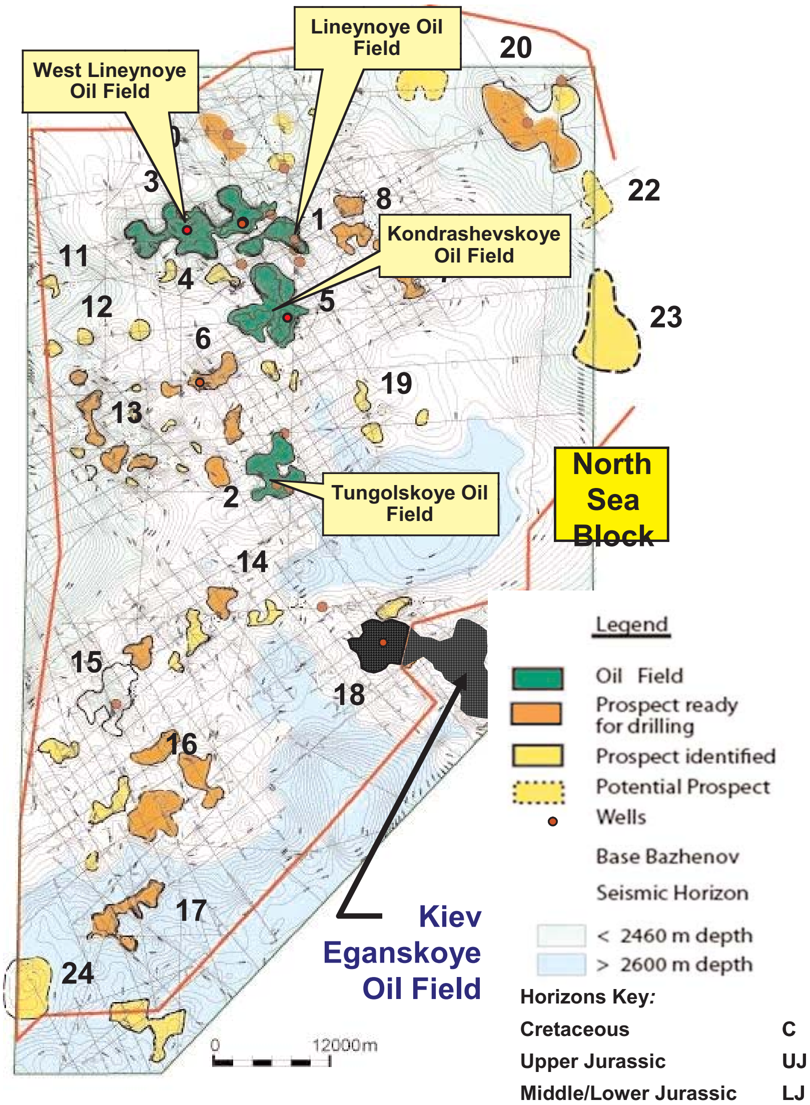
- 1,000km of 2D seismic within three years;
- Six exploration / appraisal wells drilled within six years; and
- Production to commence within two years of state approval of the reserves

Environmental constraints limited initial activity to the winter months when rigs and equipment could be transported safely across the frozen terrain. Two appraisal wells (Lineynoye # 6 and Tungolskoye # 4) and an exploration well (Lineynoye # 7) were drilled in 2007, followed by a further three exploration wells in 2008 (Korchegskaya # 1,

Environmental constraints limited initial activity to the winter months

Oil Fields / Prospects / Potential Prospects

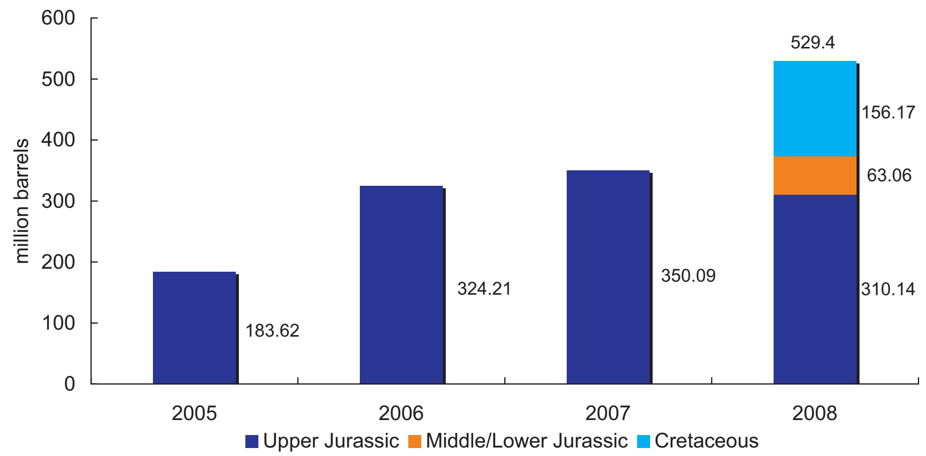
	Map ref.	Field/Prospect	Horizon(s)
Oil fields	1	Lineynoye Oil Field	UJ
	2	Tungolskoye Oil Field	UJ
	3	West Lineynoye Oil Field	UJ
	5	Kondrashevskoye Oil Field	UJ
Prospects	2	Tungolskoye West Lobe and North (2)	UJ
	4	Lineynoye Lower	UJ
	6	West Korchegskaya	LJ
	7	Arbuzovskaya (Varyakhskaya)	UJ
	8	Arbuzovskaya North & Upper (2)	UJ
	9	Emtorskaya	UJ
	10	Emtorskaya Crown	UJ
	11	Sigayevskaya	UJ
	12	Sigayevskaya East	UJ
	13	Kulikovskaya Group (2)	UJ
	14	Kusinskiy Group (2)	C, UJ, LJ
	15	Tuganskaya Group (3)	C, UJ, LJ
	16	Kirillovskaya (4)	C, UJ, LJ
	17	North Balkinskaya	UJ, LJ
	18	Traverskaya	C, UJ, LJ
	19	Tungolskoye East	UJ
	20	Sibkrayevskaya Crown & North	UJ
Potential Prospects (Leads)	21	Emtorskaya North	UJ
	22	Sibkrayevskaya East	UJ
	23	Sobachya	UJ
	24	West Balkinskaya	UJ



Lineynoye # 8 and West Korchegskaya #1) in 2008. That fulfilled the licence requirements in terms of survey and well commitments. More importantly, however, it resulted in a progressive upgrade to the Ryder Scott reserve audit for the licence, which has seen the 2P reserve estimate rise steadily from 33.5 mmbo at the time of the IPO to 70.0 mmbo currently, with gross reserves (3P) increasing from 324.2 mmbo to 529.4 over the same period. Reserve approval from the Russian state authorities (C1 + C2 reserves of 95 mmbo) was also received in January 2009. Flow testing on wells produced good quality oil (c.44° API) at rates in the range of 100 – 300 bopd. While low relative to more prolific basins, such rates are symptomatic of the tight reservoir characteristics of the region and all were achieved without artificial lift.

Drilling activity in 2007 and 2008 resulted in a progressive update to reserves with...

PetroNeft: 3P Resource Progression



Source: Ryder Scott, PetroNeft

...gross reserves (3P) increasing from 324.2 mmbo to 529.4 mmbo

PetroNeft - Historic Drilling Results

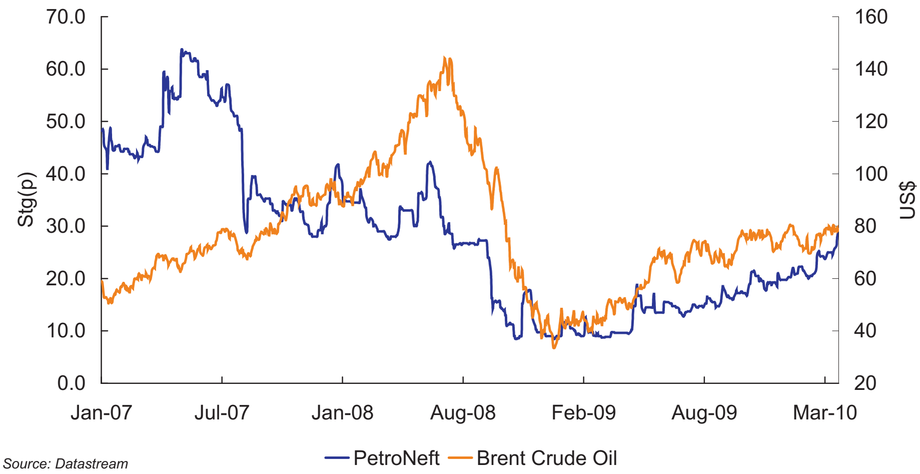
Well	Date	Net Pay m	Quality °API	Reservoir	Flow Rate bopd	Comment
Lineynoye #6	Apr-07	11.2	44	Upper Jurassic	100	Flow rate constained, un-stimulated
Tungolskoye #4	Jun-07	15.0	42	Upper Jurassic	40	Flow rate un-stimulated
Lineynye #7	Aug-07	2.0	44	Upper Jurassic	125	Flow rate un-stimulated
Korchegskaya #1	Apr-08	3.3	47	Upper Jurassic	125	Flow rate un-stimulated
Lineynye #8	Jun-08	4.0	44	Upper Jurassic	120	Flow rate un-stimulated
West Korchegskaya #1	Sep-08	-	-			Secondary target to assess
Lineynoye #1	Nov-08	15.4	44	Upper Jurassic	271	Well re-entry

Source: PetroNeft

The solid execution, particularly following the two and a half year period post IPO, might suggest a progressive increase in valuation. The reality, however, was a rapid share price rise as euphoria gripped resource stocks in the wake of the appreciation in oil prices to over $140 per barrel, to be followed by a sheer drop, as the credit markets seized and shut for business. The latter created an issue for PetroNeft given a preferred option to secure debt to fund the construction of a pipeline in a bid to enable year-round production. Negotiations on debt finance did take place during 2008 and a Mandate Letter was signed with Standard Bank in July for an $80m debt facility to finance development activity and “undertake suitable acquisitions”. The changing landscape, however, as oil prices dropped towards $40, led the Board to reach a decision in December 2008 to defer the development plan for a year. That decision, allied to market sentiment, clearly weighed on the share price, which ‘troughed’ in the 10p range in the early part of 2009.

As debt markets closed management was forced to defer the development plan for a year, which weighed on the share price

PetroNeft Vs Brent Crude



Source: Datastream

A more cost effective solution to pipe product emerged which...

Despite the immediate market reaction to the decision to defer the development plan, a 'silver lining' subsequently emerged in the shape of capex reduction. Part of that reflected the sharp depreciation of the Rouble relative to the Dollar and general cost deflation within the oil services market. A larger factor, however, related to more cost effective solutions to pipe product from the production base. The initial plan involved the construction of a 156km pipeline to the Raskino pumping station to the south west of Licence 61. That was subsequently amended to a pipeline sharing agreement with Bashneft, which operates two licences north west of Licence 61, involving the construction of a 60km pipeline. Post the decision to defer the development plan, however, a distribution deal was struck with Imperial / ONGC, which operates the neighbouring licence to the east. The end result was that pipeline and facilities costs over the above timeframe reduced considerably from the original $65m, to $40m (Bashneft option) and ultimately to $25m. The benefits of the latest agreement are that:

...resulted in a progressive reduction in development costs from $60m to $25m...

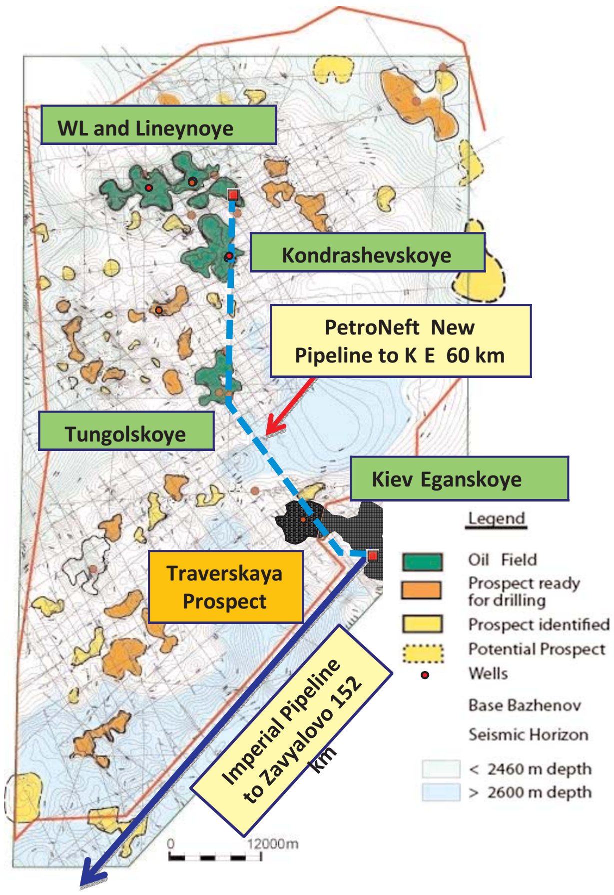
- The proposed 60km pipeline traverses all the primary licence fields and prospects;
- Limits the permitting requirements, thus reducing potential administrative delays;
- Covers the 25 year period of the licence, with tariff fees tied to adjustments based on Russian CPI.

With a pipeline agreement in place and the requisite pipe already on site, the development plan was back on track. The requisite funding was subsequently secured by way of a placing in September 2009 that raised gross proceeds of $27.5m. The outline timetable was to:

- Commence pipeline construction in February 2010;
- Complete pipeline construction in April 2010;
- Pressure-test the pipeline in June;
- Target production of 4,000 bopd by the end of the year;
- Target average production of 12,000 bopd in 2012

...and a target start date for production of Q3 2010

Market updates suggest PetroNeft is well on track to commence production in Q3



First of a nine well development campaign spudded ahead of expectations

In tandem with the infrastructure phase a nine well development contract was awarded, with drilling to commence on the first well next month. That well has since spudded three weeks ahead of schedule. The plan is to drill deviated wells on the Lineynoye field from a rail-mounted rig with recent updates suggesting that PetroNeft is well on track to commence production towards the end of Q3.

Market Approach

To date the market approach has been specific to Russia with an interest in under-developed assets that fall beneath the level of interest of the larger companies, but which incrementally, or via exploration potential, can make a material impact to a company the size of PetroNeft. Armed with a knowledge of the region, the aim is to exploit past survey inefficiencies, subsequent advances in seismic and drilling techniques and an historic emphasis on large, rather than small to medium discoveries, to build a sustainable asset base. Characteristic of the oil price environment at the time, and the challenges of operating in Siberia in the 1970's, the focus then was on the discovery of giant fields delineated by large spaced surveys. Combined with advances in well stimulation that can boost recovery rates, prospects that historically were too small to develop form the target profile for PetroNeft. In general, the portfolio consists of assets:

Regional knowledge, allied to past exploration inefficiencies, provides the opportunity to build a sustainable asset base

- With low initial flow and relatively steep decline rates (working assumption 40% decline in year 1), which necessitate an active drilling programme;
- With 'tight' reservoir characteristics, requiring the need for enhanced recovery or select technology (propose to 'fracc' wells to boost recovery rates);
- With a subsequent risk bias towards achieving adequate flow rates, rather than the

potential for discovery failure; and

- With high and generally controlling equity stakes.

Low flow rates are associated with 'tight' reservoir characteristics

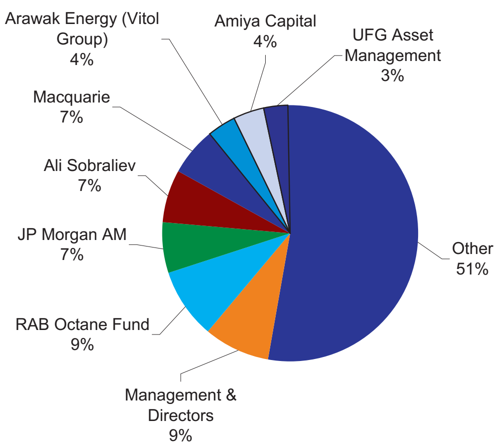
Consistent with the market approach, PetroNeft secured 100% of another licence (Ledovy licence 67) in December by way of a state auction. Located on the other side of the Ob river the licence contains an estimated gross recoverable (C3) resource base of 55 mmbo and two producing oil fields (C2 reserves of 90 mmbo), though both are excluded under the terms of the agreement. To fulfil the licence obligations, PetroNeft is committed to the acquisition of 750 km of new seismic and the drilling of a single well. An advantage of the asset location, unlike that of Licence 61, is: (i) the presence of a pipeline and power that bisect the acreage; and (ii) a paved road and alternative pipeline traversing the north western tip. Fifty percent of the interest and future costs have been acquired by Arawak Energy, which availed of its option under an Area of Mutual Interest (AMI) agreement signed in August 2008. Arawak, which has a 3.8% equity interest in PetroNeft, signed the agreement in a bid to pool resources and jointly pursue opportunities within the West Siberian basin. Aside from Russia, Canadian-listed, Arawak has interests in Kazakhstan and Azerbaijan and was itself the subject of acquisition by Vitol in 2009.

Funding Position

In the past, the stated preference of PetroNeft management has been to fund development through a balance of equity and debt. Market conditions at the time that development funding was required, however, forced it to again tap shareholders, in spite of the obvious progress made in terms of increasing the reserve base. With no debt on the balance sheet, fully funded through to production and a current stable oil price environment, the company clearly has greater options now at its disposal. Given an expectation that it will generate positive net cashflow in 2011, sourcing additional equity will likely only arise, in our view, to fund a large acquisition. Recent commentary from the CFO indicated that the company continues to scan the market for opportunities, which range from future licencing rounds to larger deals in the $20m to $30m range. Our view is that cashflow and debt, rather than equity, will be the main source of future funding with PetroNeft clearly on a more solid financial footing as production commences in the second half of the year. We estimate net cash by year end of $2.4m, rising to $10.5m by the end of the following year.

Secured second licence on western side of river in December 2009 following a state auction

Petroneft Share Register



Source: Petroneft

Funding to date has been secured via equity placings

Additional equity likely to only arise, in our view, to fund a large acquisition

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

Source: PetroNeft

PetroNeft

Balance Sheet ($m)

As at	Dec-07	Dec-08	Dec-09f	Dec-10f	Dec-11f	Dec-12f
Tangible Assets	1.6	25.6	24.5	24.5	24.5	24.5
Intangible Assets	29.4	18.7	25.9	45.2	73.9	116.0
Goodwill	0	0	0	0	0	0
Financial Assets	0	0	0	0	0	0
Fixed Assets	**31.2**	**44.5**	**50.6**	**70.0**	**98.6**	**140.7**
Debtors	3.5	3.1	1.6	4.0	14.2	23.8
Stock	0.0	0.0	0.0	0.0	0.0	0.0
Creditors	-1.3	-3.9	-2.6	-4.0	-11.8	-15.8
Non-Cash Working Capita	**2.2**	**-0.8**	**-1.0**	**0.0**	**2.4**	**7.9**
Other Liabilities	0.5	0.8	0.9	0.9	0.9	0.9
Net Debt	-8.3	-2.2	-17.7	-2.4	-10.5	-33.7
Preference Shares	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' Funds	**41.2**	**45.0**	**66.4**	**71.5**	**110.5**	**181.4**
Total	**33.4**	**43.7**	**49.7**	**70.0**	**101.0**	**148.6**

Cashflow Statement ($m)

Year End	Dec-07	Dec-08	Dec-09f	Dec-10f	Dec-11f	Dec-12f
Operating Profit	-3.4	-7.8	-2.9	5.7	48.4	87.4
DD&A	0.0	0.0	0.1	7.3	9.6	12.9
Chg in Working Capital	0.0	0.0	2.0	-1.0	-2.4	-5.6
Other	0.4	-3.0	0.2	0.0	0.0	0.0
Operating Cashflow	**-3.0**	**-10.8**	**-0.6**	**12.0**	**55.6**	**94.7**
Net Interest Payable	0.5	0.1	0.0	0.5	0.3	1.0
Dividends Received	0.0	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0	0.0
Taxation	0.0	0.0	-0.1	-1.1	-9.7	-17.5
Net Capex	0.0	0.0	-10.0	-26.6	-38.2	-55.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Free Cashflow	**-2.6**	**-10.7**	**-10.6**	**-15.3**	**8.0**	**23.2**
Acquisitions/Dev Capex	0.0	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Issue / Buyback of Shares	0.0	0.1	26.1	0.0	0.0	0.0
Currency Translation	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.1	0.0	0.0	0.0
(Inc)/Dec in Net Debt	**-2.6**	**-10.7**	**15.5**	**-15.3**	**8.0**	**23.2**

Anticipate positive net cashflow from 2011 onwards

Investment Catalysts

Given historic and current events the primary catalysts for the share price relate to the start of production. Milestones along that road are likely to take the form of:

- An announcement regarding the completion of pipeline construction and the start of the commissioning process during Q2;
- A subsequent announcement in Q3 to confirm that the commissioning of the pipeline is complete and year-round production has commenced;
- An announcement on the mobilisation of a rig to drill an exploration well in October (Arbuzovskaya #1), debt finance for which has been secured by way of a $5m facility (in exchange for 4.7m warrants at 30p) with Macquarie Bank.

Primary catalysts for share price relate to the start of production

Valuation

Development assets risked at 70% even though a case...

As is the case with other oil and gas companies covered, our primary valuation approach is derived from a DCF of the assets within the portfolio based on: (i) outlined reserves; (ii) our underlying commodity assumptions; (iii) an estimated production profile and (iv) a discount rate of 10%. The audited development assets within the portfolio (Lineynoye, West Lineynoye, Tungolskoye and Kondrashevskoye) are risked at 70% even though a case could be made for the reserves associated with the first two fields in that list to be given a full weighting in light of the pending start of production. Core NAV, which includes the net cash balance at the end of June, amounts to 57.3p.

PetroNeft Price/Forex Assumptions

	2010	2011	2012
Oil Price - ($/barrel)	75.00	80.00	80.00
$/£ Exchange Rate	1.49	1.56	1.90

Source: Goodbody Stockbrokers

Assets within the higher risk portion of the NAV relate to the potential to be derived beyond the primary geological horizon in Licence 61 (Upper Jurassic) and the prospects that lie within the recently acquired Licence 67. Of particular note with regard to the former was the discovery in June 2008 of oil in the lower Cretaceous by Imperial in the neighbouring Block 80 at the Kiev-Eganskoye field. That field marks the delivery point for the pipeline currently being constructed with the well in question flowing unassisted at a rate of 1,800 bopd. Combined, those assets, risked at 10%, add 6.3p to our NAV resulting in a Total NAV of 63.5p.

...could be made to fully de-risk, in light of the pending start of production

PetroNeft NAV Calculation

	W.I. Reserves mmboe	Risk Weighting	NAV $m	NAV/Share p	Unrisked $m	Unrisked p
Risked Development						
Licence 61						
Lineynoye	23.8	70%	112.0	19.8	160.0	28.3
West Lineynoye	23.3	70%	109.6	19.3	156.5	27.6
Tungolskoye	14.8	70%	69.5	12.3	99.2	17.5
Kondrashevskoye	8.1	70%	38.1	6.7	54.5	9.6
(Licence 61) Total			329.2			
Risked Dev NAV	**70.0**		**329.2**	**58.1**	**470.3**	**83.0**
Less Net Debt			1.3	0.2		0.2
Total Core NAV (pence)			**330.5**	**58.3**		**83.3**
High Risk Exploration	**W.I. Reserves mmboe**	**Risk Weighting**	**Risked $m**	**Risked p**	**Unrisked $m**	**Unrisked p**
Licence 61						
Upper Jurassic	41.5	10%	17.2	3.0	172.4	30.4
Cretaceous	31.2	10%	13.0	2.3	130.2	23.0
Lower - Middle Jurassic	12.6	10%	4.3	0.8	43.0	7.6
Licence 67						
Ledovy	5.5	10%	0.9	0.2	8.6	1.6
High Risk Explor NAV	**90.8**		**35.4**	**6.3**	**354.2**	**62.7**
Total NAV			**365.9**	**64.6**		**145.9**

Source: Goodbody Stockbrokers

Core NAV of 58.3p

Total risked NAV of 64.6p

PetroNeft Audited Reserves & Resource Estimates

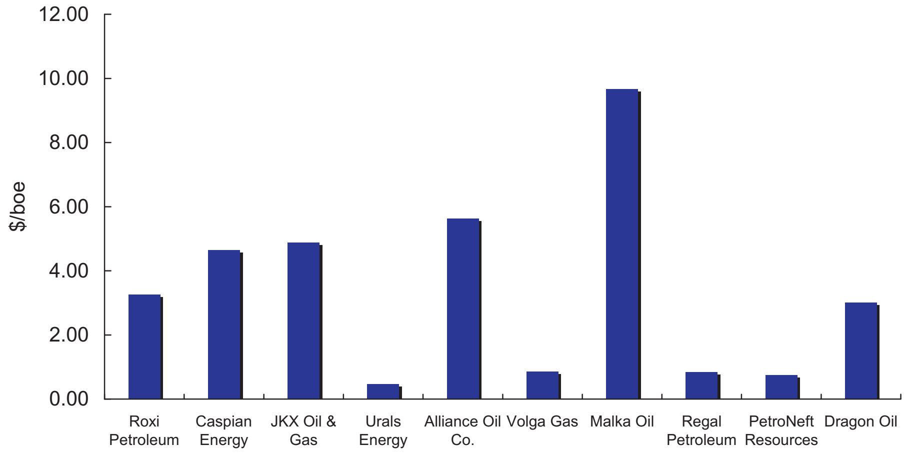
Field / Prospect Name	Proved 1P million bbls	Proved & probable 2P million bbls	Proved, probable & possible 3P million bbls
Lineynoye field	5.69	23.82	28.65
West Lineynoye field	2.71	23.30	29.19
Kondrashevskoye field	0.39	8.11	26.10
Tungolskoye field	1.42	14.77	18.91
Total	**10.21**	**70.00**	**102.85**
Upper Jurassic - 24 prospects			207.29
Cretaceous - 10 prospects			156.17
Lower to mid Jurassic - 11 prospects			63.06
Total	**10.21**	**70.00**	**529.37**

Source: PetoNeft, Ryder Scott

On a relative basis, value is also apparent when compared to the regionally exposed peer group on the basis of EV/boe and EV/Total Resources. While we acknowledge that the comparison is somewhat flawed, given the disparity in terms of production and asset profile, it nevertheless underpins the value that we perceive in deriving our NAV.

Value also apparent on a relative basis...

EV/2P Reserve Comparison



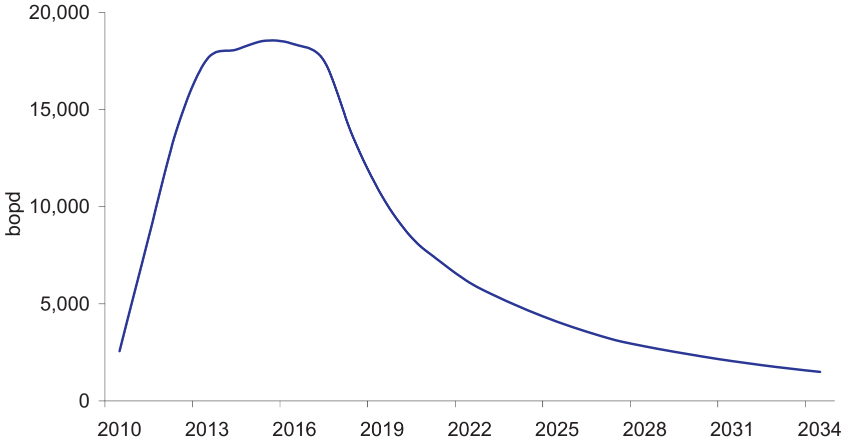
Source: PetroNeft, Thomson

Our production profile for Licence 61 assumes production commences on schedule in the second half of the current year rising to peak at 18.5 kbopd in 2015 and subsequently trailing out over the course of the licence, which extends to 2034. To achieve the peak rate of production we assume over 100 wells drilled over a six year period. Derived revenue assumes 67% of production sold to the domestic market at a 45% discount to Brent with the remainder sold for export. Operating expenses include tariff tees amounting to $9.5 per barrel, which account for transportation costs.

...when compared to regionally exposed peers

Our production profile models a rate of production in 2015 of 18.5 kbopd

Licence 61 Production Profile



Source: Goodbody

Recommendation

Despite a funding constraint in 2008 management in PetroNeft would appear to be on the cusp of delivering its inaugural asset through the appraisal and development phase to production within a four year timeframe and in what amounts to a challenging operating environment. Risks in achieving a scheduled Q3 start date for production would now appear to rest with the successful commissioning of the distribution pipeline and the drilling of nine development wells, the first of which is currently being drilled. Achieving the target start date will clearly have a profound impact on the model in that it moves PetroNeft firmly into self-funded mode and largely eliminates the dilutive effect associated with the need to raise equity from shareholders. The transition will also provide funds to secure additional acreage and thus set up the prospect for PetroNeft to repeat the cycle based on a proven track record.

Our revenue model assumes 67% of production sold to the domestic market at a 45% discount to Brent

Valuation, both on an absolute (Risked NAV) and relative basis (EV/boe), suggests value, with the former providing the basis for our price target of 65p. Catalysts over the coming months relate to anticipated announcements on development wells and pipeline progress. We initiate coverage with a Buy recommendation.

Achieving target start date for production shifts the model into self-funded mode

PetroNeft

Mkt Cap (£m) **108.66**

Financial Overview ($m)

Year Ending	**Dec-07**	**Dec-08**	**Dec09f**	**Dec10f**	**Dec11f**	**Dec12f**
Group Sales	**0.0**	**0.0**	**2.1**	**49.1**	**172.3**	**289.0**
Cost of Sales	0.0	0.0	-1.5	-39.7	-120.0	-197.6
Gross Profit	**0.0**	**0.0**	**0.6**	**9.4**	**52.3**	**91.4**
Administration Expenses	-3.8	-4.8	-3.5	-3.7	-3.9	-4.1
Exploration Write Off	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA	**-3.4**	**-7.8**	**-2.9**	**13.0**	**58.0**	**100.3**
Operating Profit (ex Goodwi	**-3.8**	**-4.8**	**-2.9**	**5.7**	**48.4**	**87.4**
Goodwill Write-off	0.0	0.0	0.0	0.0	0.0	0.0
Other Income	0.4	-3.0	0.0	0.0	0.0	0.0
Associates / Joint Ventures	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional Gain / (Loss)	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	**-3.4**	**-7.8**	**-2.9**	**5.7**	**48.4**	**87.4**
Interest Income / (Expense)	0.5	0.1	0.0	0.5	0.3	1.0
PBT	**-3.0**	**-7.7**	**-2.9**	**6.2**	**48.7**	**88.4**
Tax	-0.3	-0.2	-0.2	-1.1	-9.7	-17.5
Minorities	0.0	0.0	0.0	0.0	0.0	0.0
Preference Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Attributable Profit	**-3.2**	**-7.9**	**-3.1**	**5.0**	**39.0**	**70.9**
Net Debt (Cash)	-8.3	-2.2	-17.7	-2.4	-10.5	-33.7
Shareholders' Funds	41.2	45.0	66.4	71.5	110.5	181.4
Enterprise Value	48.6	62.2	91.0	106.2	98.2	75.0
Weighted Av Shares (basic)	183.7	207.5	350.5	350.5	350.5	350.5
Weighted Av Shares (fully dil.)	183.7	207.5	360.4	360.4	360.4	360.4
Year end Shares	183.7	207.5	350.5	350.5	350.5	350.5
Per share Analysis (c)						
FRS3 EPS	-1.7	-3.8	-0.9	1.4	11.1	20.2
FD EPS	-1.7	-3.8	-0.9	1.4	10.8	19.7
Adjusted EPS	-1.7	-3.8	-0.9	1.4	10.8	19.7
DPS	0.0	0.0	0.0	0.0	0.0	0.0
Dividend Cover (x)	n/a	n/a	n/a	n/a	n/a	n/a
Operating Cashflow	-1.6	-5.2	-0.2	3.4	15.9	27.0
Free Cashflow	-1.4	-5.2	-3.0	-4.4	2.3	6.6
NAV	22.4	21.7	19.0	20.4	31.5	51.8
Profitability						
EBITDA Margin	n/m	n/m	n/m	26.5%	33.6%	34.7%
EBIT Margin	n/m	n/m	n/m	11.7%	28.1%	30.2%
Effective Tax Rate	-8.5%	-2.7%	-7.5%	18.5%	19.9%	19.8%
Momentum						
Sales	n/m	n/m	n/m	n/m	251.0%	67.7%
EBITDA	n/m	n/m	n/m	n/m	345.6%	73.0%
Adjusted EPS	n/m	n/m	n/m	n/m	672.7%	81.7%
DPS	n/a	n/a	n/a	n/a	n/a	n/a
Financing						
Debt/Equity (%)	-25.2%	-5.1%	-36.3%	-3.5%	-10.5%	-22.8%
Interest Cover (x)	7.3	61.0	1439.2	-28.7	-199.7	-101.0
Valuation (x) £p 31						
P/E	**-26.7**	**-12.2**	**-54.2**	**33.2**	**4.3**	**2.4**
P/OpCF	-28.2	-8.9	-291.8	13.5	2.9	1.7
Dividend Yield (%)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
EV/Sales	n/m	n/m	43.9	2.2	0.6	0.3
EV/EBITDA	**-14.2**	**-7.9**	**-31.6**	**8.2**	**1.7**	**0.7**
EV/EBIT	-14.2	-7.9	-31.6	18.5	2.0	0.9
P/Book	2.1	2.1	2.5	2.3	1.5	0.9

Appendix I

Board Members

David Golder: Non-Executive Chairman

Mr. Golder has been Non-Executive Chairman of the Company since 2005. He is also Chairman of the Remuneration Committee and a member of the Audit Committee. He has over 38 years experience in the petroleum industry and was formerly Senior Vice President of Marathon Oil Company (Marathon), retiring in 2003. He has performed at executive and director level for two major corporations (Marathon Oil Company and Sakhalin Energy Investment Company). From June 1996 to 1999, Mr. Golder was seconded from Marathon to Sakhalin Energy Investment Company where he was Executive Vice President — Upstream. Located in Moscow, he managed all upstream activities which focused on the oil development and company infrastructure aspects of the Sakhalin II Project onshore and offshore Sakhalin Island; this included the planning and implementation of the US$650 million development of the Piltun-Astokhskoye oil field and associated infrastructure. He was also Co-Chairman of the Joint Supervisory Board which oversaw the Sakhalin II Production Sharing Agreement. Mr. Golder is currently President of David Golder Consulting, LLC and a member of the Society of Petroleum Engineers. He has a BSc degree in Petroleum & Natural Gas Engineering from Pennsylvania State University and has completed the Program for Management Development at Harvard University.

Dennis Francis: CEO, Executive Director

Mr. Francis has been Chief Executive Officer and an Executive Director of the Company since its formation in 2005. He has over 37 years experience in the petroleum industry and was with Marathon for 30 years. 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 putting together 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 managed the progression of this project within Marathon. He represented Marathon as shareholder and was a director on the board of Sakhalin Energy Investment Company during the Phase I Project Development. He was also a member of the joint supervisory board with oversight responsibility for the Sakhalin II Production Sharing Agreement. He was a recipient of the Governor of Sakhalin Award for his efforts associated with the Sakhalin II Project. He also managed Marathon’s acquisition of the Khanty Mansiysk Oil Company in 2003. He is a member of the American Association of Petroleum Geologists and Society of Exploration Geophysicists. He has a BSc degree in geophysical engineering and an MSc degree in geology both from the Colorado School of Mines. He has also completed the Program for Management Development at Harvard University.

Dr David Sanders: General Legal Counsel, Executive Director, Company Sectretary

Dr. Sanders has been Vice President, General Legal Counsel, Executive Director and Company Secretary of the Company since its formation in 2005. He is an attorney of law and has over 35 years experience in the petroleum industry, including 18 years of doing business in Russia and three years in the oil and gas litigation division of the law firm of Fulbright & Jaworski LLP. In 1988, Dr. Sanders joined Marathon where he analyzed 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.

Paul Dowling: CFO, Executive Director

Mr. Dowling 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). He is also a non-executive Director of Moesia Oil & Gas plc, an unlisted Company, focused on oil and gas exploration and development in Romania and Bulgaria.

Thomas Hickey: Independent Non-Executive Director

Mr. Hickey has been a Non-Executive Director of the Company since 2005. He is Chairman of the Audit Committee and a member of the Remuneration Committee. Mr Hickey was Chief Financial Officer and a director of Tullow Oil plc from 2000-08. During this time Tullow grew via a number of significant acquisitions including the $570 million acquisition of Energy Africa in 2004 and the $1.1 billion acquisition of Hardman Resources Limited in January 2007, and through exploration success, leading the establishment of new oil provinces in Ghana and Uganda. The Company now has market capitalization of over £9 billion. 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 the areas of fund raising, stock exchange requirements, mergers and acquisitions, and related transactions. Mr. Hickey is a Commerce graduate of University College Dublin and a Fellow of the Irish Institute of Chartered Accountants. He is also a non-executive Director of Ikon Science Limited, a geological software company in which Tullow is a significant minority shareholder.

Vakha A Sobraliev: Non-Executive Director

Mr. Sobraliev has been a Non-Executive Director of the Company since 2005. He is a member of the both the Audit and Remuneration Committees. He has over 30 years experience operating and managing energy service companies and state operating units exploring for and exploiting oil resources in the Western Siberian Oil 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. From 1975 to 2000, Mr. Sobraliev worked for Tomskneft and Strezhevoy Drilling Boards in various drilling and economic capacities including chief engineer and chief accountant. He has degrees in mining engineering and economics from Tomsk Polytechnic Institute and the Tomsk State University respectively. Mr. Sobraliev is a resident of Tomsk, Russia.

Appendix II

Key Senior Management

Karl Johnson: Vice President Business Development and Operations

Mr. Johnson joined the Company on January 1, 2010 as VP of Business Development and Operations. He has 30 years of experience in the petroleum industry, and was with Marathon for over 27 years. He started with Marathon as a reservoir/production engineer and has worked primarily on international projects. In 1991 he coordinated the preparation of a feasibility study for the development of a field in Western Siberia. In 1992, he lead the economic analysis of the Sakhalin II Project during the feasibility study, and later became part of the negotiating team that negotiated the first Production Sharing Agreement in Russia. Mr. Johnson was then seconded to Sakhalin Energy Investment Company and held positions of Approvals Manager in Moscow, and Russian Content Manager in Sakhalin. After Marathon left the Sakhalin II Project, he headed up Marathon's Moscow office as VP of Business Development.

He is a member of the Society of Petroleum Engineers (SPE) and the Association of International Petroleum Negotiators (AIPN). He has a BS degree in Petroleum Engineering from Marietta College, Marietta, Ohio, USA, and recently completed an Executive MBA degree from Rice University, Houston, Texas, USA.

Alexey Balyasnikov: General Director

Mr Balyasnikov has over 32 years 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. Most recently he has worked for Petroneft LLC on numerous projects including under contract to Foster Wheeler Energy LTD as Russian Project Manager of a large due diligence project for TNK-BP in Western Siberia. 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: Managing Director

Mr Frenovsky, a former general director and chief engineer of JSC Tomskneftegazgeologia, the former Russian state enterprise that discovered and delineated essentially all of the oil and gas fields in the Tomsk Region. Mr Frenovsky has over 34 years experience in the oil industry and has received a state medal ''For Development of the Subsurface and Oil and Gas Complex of West Siberia'' and the ''Merited Worker of Geological Exploration'' badge of honour. He participated in the discovery of fields in the Tomsk Region and took part in the development of over 15 of the oil fields. Mr Frenovsky graduated in 1971 from the Oil University in Ufa, with a specialisation in ''drilling of oil and gas wells''.

Dr Nikolay Karapuzov: Chief Geologist and Geophysicist

Dr Karapuzov was chief geophysicist/chief geologist of JSC Tomskneftegazgeologia. He worked for JSC Tomskneftegazgeologia for 35 years and directly participated in the discovery of 17 oil fields in the area and has been awarded the title ''Honourable Geologist of Russia'' by the Russian government for his contribution to the development of the subsurface in Tomsk Region. Dr Karapuzov graduated from Voronezh State University in 1970 with specialisation in ''geophysical methods of prospecting and exploration of hydrocarbons''.

Issuer & Analyst Disclosures

Recommendation History

PetroNeft Resources	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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We would like to inform you that Gerry Henningan holds shares in PetroNeft Resources

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