Oil and gas alternatives
Russia

Initiation of coverage
Equity research

5 November 2009

Renaissance Capital

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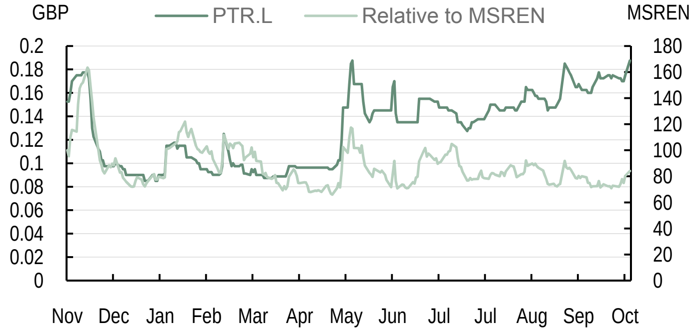
PetroNeft Resources
Proved potential

- **Prime location.** PetroNeft is an early-stage appraisal and development oil company, located in Russia's Tomsk region, offering investors exposure to the prolific West Siberian oil and gas basin. Local oil production is carried out mainly in the north-west and in the north of the Tomsk region, while the east of the Ob River area (where PetroNeft's only asset, Licence 61, is located) is underexplored and has significant exploration potential, according to the Russian Academy of Science.
- **PetroNeft's 2P reserves offer production potential of 18kboepd.** According to Ryder Scott, PetroNeft's total resource base amounts to 354.4mn boe, comprising 70.0mn boe of proved and probable reserves, 269.4mn boe of risked possible reserves and 14.9mn boe of risked resources. The company's immediate opportunity is therefore represented by the development potential of its 2P reserves, which could see peak oil production of 18kboepd, according to Ryder Scott. Additional potential is offered by the appraisal of 45 identified possible prospects, as well as exploration opportunities.
- **Fully funded.** Thanks to the successful capital raising undertaken in Sep 2009, PetroNeft presently has a cash position of $27.4mn (including the 30 June 2009 cash balance of $1.3mn) and is fully funded. We believe the company is in a position to start year-round production of crude in 3Q10, following the construction of pipeline infrastructure and completion of nine development wells. PetroNeft's investment programme requires a total of $335mn to fully develop its 2P reserves base over the next 10 years, on our estimates, which it should be able to fund from operating cash flows once production has started.
- **We initiate coverage with a BUY rating and target price of GBP0.51/share.** We see PetroNeft as offering an attractive risk-return profile, underwritten by its substantial asset base, strong management team and fully funded status. It is also cheap trading at an EV/2P reserves multiple of just $1.1/boe, a 59% discount to its closest listed comparable, Malka Oil, on our estimates. We think the company's small scale and the lack of a strategic investor are bound to concern minority shareholders. However, in our view, this is offset by the inherent attractiveness of the company's Licence 61 location, leading to potential exploration and M&A opportunities (as evidenced most recently by the success of Imperial Energy).

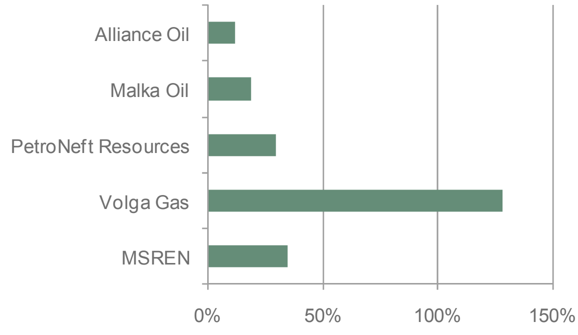
Report date:	5 November 2009	
Rating		BUY
Target price, GBP		0.51
Current price (comm), GBP		0.18
Current price (pref), GBP		n/a
MktCap, $mn		103
EV (2009E), $mn		118
Reuters		PTR.L
Bloomberg		PTR LN Equity
ADRs/GDRs since		n/a
ADRs/GDRs per common share		n/a
Common shares outstanding, mn		349.86
Change from 52-week high:		-2.6%
Date of 52-week high:		06/05/2009
Change from 52-week low:		127.3%
Date of 52-week low:		10/03/2009
Web:		www.petroneft.com
Free float in $mn		79.1
Major shareholder with shareholding		RAB (10.82%)
Average daily traded volume in $mn		0.1
Share price performance over the last	1 month	15.39%
	3 months	29.31%
	12 months	108.33%

Figure 1: Price performance – 52 weeks



Source: Bloomberg

Figure 2: Sector stock performance – three months



Sourcece: Bloomberg

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Investment summary

PetroNeft is an early-stage appraisal and development oil company, located in Russia's Tomsk region, offering investors exposure to the prolific West Siberian oil and gas basin. This is the largest oil and gas basin in the world in terms of area (3.4mn km2) and second largest to the Middle East in terms of reserves.

Prime location in a hydrocarbon-rich region

The Tomsk region, in West Siberia, has very substantial oil reserves: 267mnt of ABC1 reserves and 1,800mnt of resources. Prospective oil- and gas-bearing areas account for 72% of the region, however, of 118 discovered fields, only one is large scale (Myldyzhynskoye).

Numerous Russian oil companies operate in the Tomsk region, including Rosneft, Gazprom neft, TNK-BP and Russneft. It is also home to several junior exploration, appraisal and development companies, including Imperial Energy (recently taken over by ONGC), Malka Oil and PetroNeft. Oil production is carried out mainly in the north-west and north of the region, while the east of the Ob River area (where PetroNeft's licence is located) is underexplored and has significant exploration potential, according to the Russian Academy of Science. Due to the absence of development activity in the eastern area, there is almost no infrastructure there.

PetroNeft's only asset is the 4,991.8 km2 Licence 61 (Tungolsky), located in the north-west of the Tomsk Region, to the East of the Ob River (see Figures 3 and 15). The asset lies 60 km from the nearest main oil pipeline (Strezhevoy-Tomsk).

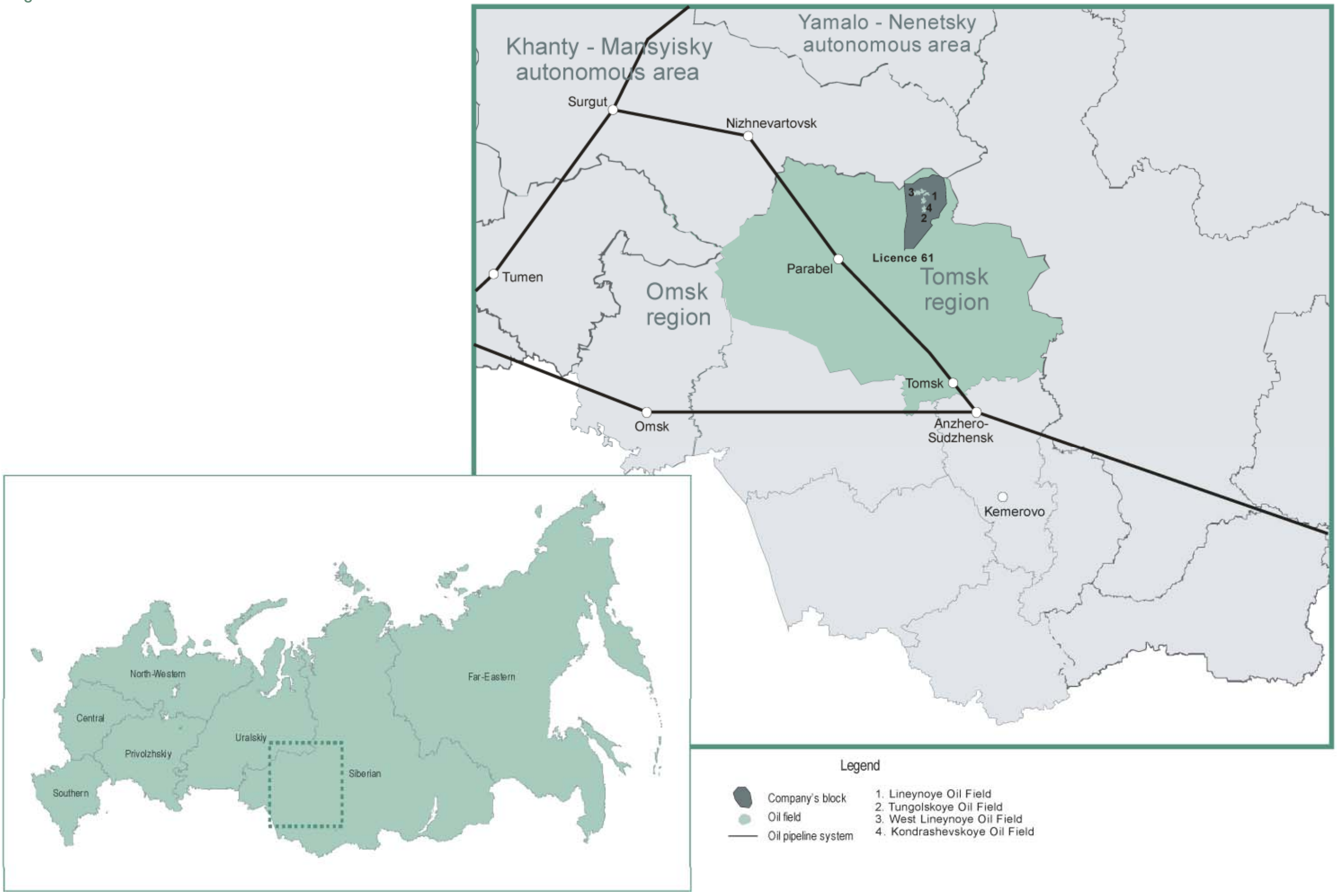
PetroNeft's 2P reserves offer production potential of up to 18kboepd

According to Ryder Scott's evaluation of PetroNeft's resource base, the company's total resources amount to 354.4mn boe, comprising 70.0mn boe of proved and probable reserves, 269.4mn boe of risked possible reserves and 14.9mn boe of risked resources (see Figure 16). The company's immediate opportunity is therefore represented by the development potential of its 2P reserves, which could generate oil production of approximately 18kboepd, according to Ryder Scott. Additional potential is offered by the appraisal of 45 identified possible prospects. Further exploration potential exists in four already identified prospective structures in the Bazhenov horizon, as well as in yet unexplored lower Cretaceous horizons, as evidenced by the 1,575 bopd discovery in 2008 at Imperial Energy's Kiev-Eganskoye oilfield, located in the neighbouring Licence 80, to the east of PetroNeft's Licence 61.

We initiate coverage with a BUY rating and target price of GBP0.51/share

We see PetroNeft as offering an attractive risk-return profile, underwritten by its substantial asset base, strong management team and fully-funded status (with a net cash position of $27.4mn). It is also cheap, trading at an EV/2P reserves multiple of just $1.1/boe, a 59% discount to its closest listed comparable, Malka Oil, on our estimates. We think the company's small scale and the lack of a strategic investor are bound to concern minority shareholders. However, in our view, this is offset by the inherent attractiveness of the company's Licence 61 location, leading to potential exploration and M&A opportunities (as evidenced most recently by the success of Imperial Energy).

Figure 3: PetroNeft Resources' assets



Source: Company data

Valuation

We set out our valuation of PetroNeft below, based on a number of methodologies (as summarised in Figure 4). Typically for an early-stage exploration and production company, the valuation range is relatively wide, at GBP0.28-0.51/share, representing a premium of 56-183% to the current share price of GBP0.18. Our target price of GBP0.51/share is traditionally set using a DCF approach, and represents 183% upside potential to the current share price.

Figure 4: PetroNeft Resources: summary valuations

Valuation method	Estimated equity value		
	$mn	$/share	GBP/share
DCF	289.9	0.83	0.51
Peer group multiples (based on EV/resources comparison with FSU oil peer group)	160.3	0.46	0.28
M&A-based valuation	259.5	0.74	0.45
PV20 plus other assets	249.2	0.71	0.44

Source: Renaissance Capital estimates

DCF valuation

Our DCF model for PetroNeft spans 2P production and capex levels, and is based on Ryder Scott's reserves report, which evaluated the company's resources, as well as income and production potentials as of 1 Jan 2009. We have relied on the Ryder Scott report for production and capex forecasts (with some adjustments), but used our own oil-price forecasts (currently $60.6/bbl average in 2009, $70/bbl in 2010 and $80/bbl in 2011).

Our DCF valuation is summarised in Figure 5. As for an ungeared company, we use a WACC of 15.43%, which assumes a 7.43% risk-free rate (the current YtM for 10-year Russian sovereign eurobonds), an 8% equity-risk premium and a beta of 1.0.

Figure 5: DCF valuation of PetroNeft Resources, $mn (unless stated otherwise)

	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E
Net income	(1.7)	8.7	45.2	64.4	79.2	89.2	74.7	71.8	60.4	45.1
DD&A	0.3	1.4	3.5	6.7	10.0	12.9	15.4	18.2	20.3	20.9
Cash flow from operations	(1.4)	10.0	48.7	71.1	89.2	102.1	90.1	90.0	80.7	66.0
Capex	(4.4)	(17.5)	(34.2)	(51.7)	(52.4)	(46.4)	(40.0)	(44.6)	(33.6)	(9.9)
Net cash flow	(5.8)	(7.5)	14.5	19.4	36.8	55.6	50.1	45.4	47.2	56.1
DCF value	132.1	158.3	190.1	205.0	217.2	213.9	191.3	170.6	151.5	127.7
Estimated value of 284.4mn bbls of risked possible reserves and resources	116.6	116.6	116.6	116.6	116.6	116.6	116.6	116.6	116.6	116.6
Cash (net debt)	22.5	15.0	29.5	48.91	85.7	141.4	191.5	236.9	284.1	340.3
Equity value	271.1	289.9	336.2	370.5	419.5	471.9	499.4	524.2	552.2	584.6
Equity value per share, $	0.77	0.83	0.96	1.06	1.20	1.35	1.43	1.50	1.58	1.67
Equity value per share, GBP	0.47	0.51	0.59	0.65	0.73	0.82	0.87	0.92	0.96	1.02

Source: Renaissance Capital estimates

Our DCF value of PetroNeft's visible production amounts, therefore, to $158mn as of the beginning of 2010. To this we add the $117mn estimated value of the company's 284.4mn boe of risked possible reserves and risked resources (valued at an average EV/total resources valuation of $0.41/boe for its FSU oil peer group, as discussed below), then add to the resulting amount the estimated YE10 net cash of $15.0mn. This results in a YE10 equity valuation for PetroNeft of $289.9mn, or GBP0.51/share – 183% above the current share price.

Peer-group valuation

Among the oil and gas alternatives we cover, PetroNeft has few direct peers. Imperial Energy, which had been the closest (as discussed in the next sub-section of this report), was acquired by India's ONGC in early 2009; Alliance Oil Company has refining capacity; Volga Gas and Regal Petroleum focus on gas rather than oil development; Urals Energy is continuing to dispose of its key assets to Sberbank, and its shares have been suspended from trading until the release of its FY08 accounts. Financial comparisons are further constrained by the early stage of PetroNeft's development, meaning the company is unlikely to generate any significant net income, on our estimates, until 2010, when its first commercial oil production should start. Nevertheless, PetroNeft's 2012E P/E and EV/EBITDA multiples of just 1.6x and 0.6x, respectively (see Figure 7), look highly attractive to us in their own right.

We think peer comparisons based on EV/2P reserves and EV/total resources multiples are much more appropriate (see Figures 8 and 9). PetroNeft is currently trading with an EV/2P reserves multiple of 1.1x and an EV/total resources multiple of 0.2x, which represent 90% and 48% respective discounts to its closest comparable FSU oil peers (including Malka Oil, Roxi Petroleum, Frontera Resources, Max Petroleum and Caspian Energy). We note that PetroNeft is 59% and 71% cheaper than Malka Oil in terms of EV/2P reserves and EV/total resources multiples, respectively. We regard Malka Oil as PetroNeft's most closely comparable trading peer, as it also owns assets in the Tomsk region, and these assets are of a similar size (Malka Oil's 2P reserves are 44mn boe vs PetroNeft's 70mn boe).

Applying the average EV/total resources multiple of $0.41/boe of its FSU oil peer group to PetroNeft's total reserves and risked resources estimate of 354.4mn boe gives us an estimated EV of $145.3mn for the company. To this, we add $15.0mn of net cash at YE10 to arrive at an estimated equity value of $160.3mn, or GBP0.28/share, representing 56% upside potential to the current share price, but a 45% discount to our DCF valuation.

M&A-based valuation

Due to the stock-market shock caused by the ongoing global financial crisis, we believe the era of high M&A transaction multiples is over for some time. The valuations paid for FSU exploration and production assets have deteriorated accordingly (see Figure 10), from the high of $8.7/boe of total resources paid by ENI for Burren Energy (with assets in Turkmenistan) in Dec 2007, to the low of $0.11/boe marked by Macquarie Bank's acquisition of a 25% stake in Max Petroleum earlier this year. Over 2003-2009, we estimate an average EV/2P reserves multiple of $3.1/boe was paid for FSU hydrocarbon producers, while the average EV/total resources multiple stands at $2.10/boe (although resource-rich plays have, understandably, demanded lower multiples).

We believe the most representative deal among the recent M&A transactions for valuing PetroNeft is the acquisition of Imperial Energy by India's ONGC, which was announced in Aug 2008 and completed in early 2009. Although Imperial Energy is 4.4x bigger than PetroNeft in terms of its resource base, and it had already demonstrated an average production level of 10kbpd by the time of the offer announcement, the assets of both companies are located in the Tomsk region, and therefore bear comparable geological characteristics and cost structures. ONGC paid $1.4/boe of Imperial Energy's total resources. Conservatively applying a 50% discount to this valuation multiple (as the offer was announced just before the crisis fully broke), we multiply PetroNeft's 354.4mn boe of total reserves and risked resources by $0.69/boe, then add $15.0mn of estimated YE10 net cash to arrive at our equity valuation of $259.5mn, or GBP0.45/share, which is 2.5x above PetroNeft's current share price.

PV20 valuation

A simpler way to look at the company's value is to use the reserves auditor's estimates of the cash flows generated by the company's proved and probable reserves, discounted at 20% (the most conservative scenario).

Ryder Scott evaluates the company's reserves in two phases, linking the development schedule to infrastructure availability. Phase one includes the development of the West Lineynoye (from 2010) and Lineynoye (from 2012) oilfields, along with the construction of a 60 km pipeline to Bashneft and a simplified custody transfer point at the Lukpaiskaya pumping station. Phase two covers phase one, plus the incremental addition into production of the Tungolskoye (from 2012) and Kondrashevskoye (from 2015) oilfields.

Ryder Scott estimates PV20 for PetroNeft's assets in Russia at $117.6mn (see Figure 6), using constant prices and unit costs in the long term. Importantly, the reserves auditor applies a long-term average realised oil price of $45.86/bbl, assuming both export and domestic crude sales. Our model assumes all PetroNeft's crude is sold domestically at a long-term price of $34.3/bbl (equivalent to an $80/bbl Brent price), which is 25% lower than Ryder Scott's assumption. However, we use a lower discount rate of 15.4% which results in a higher DCF value of $153.3mn.

To the PV20 valuation we add the $116.6mn value of PetroNeft's 284.4mn boe of risked possible reserves and risked resources (valued at an average EV/total resources valuation of $0.41/boe for its FSU oil peer group, as discussed earlier) and then add to the resulting amount the estimated YE10 net cash of $15.0mn. This exercise yields a theoretical equity value for PetroNeft of $260.4mn, or GBP0.44/share (representing a 13.7% discount to our DCF valuation and 144% premium to PetroNeft's current share price).

Figure 6: Ryder Scott discounted future net income estimates of reserves, $000

Discount rates	8%	10%	12%	15%	20%
Phase 1 (West Lineynoye and Lineynoye oilfields)					
Proved reserves	59,549	54,465	49,923	43,971	35,886
Probable reserves	160,271	128,994	103,996	75,295	43,347
Total phase one	219,820	183,459	153,919	119,266	79,233
Phase two (phase one plus the incremental development of the Kondrashevskoye and Tungolskoye oilfields)					
Proved reserves	68,357	61,449	55,430	47,764	37,757
Probable reserves	271,665	220,568	179,628	132,502	79,882
Total phase two	340,022	282,017	235,058	180,266	117,639

Source: Ryder Scott reserves report (as of 1 Jan 2009)

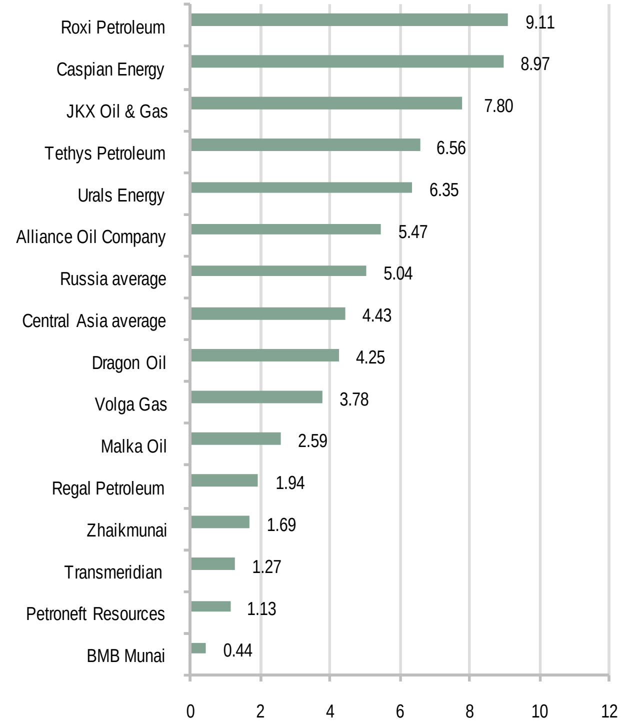
Figure 7: Comparable multiples analysis for alternative oil and gas companies

	Country	Reuters ticker	Currency	Current price 30 Oct 2009	MktCap, $mn	P/E		EV/EBITDA		EV/production		EV*/reserves (2P), $/boe	EV*/resources, $/boe
						2009E	2012E	2009E	2012E	2009E	2012E		
PetroNeft Resources	Russia	PTR.L	GBP	0.18	102.7	n/a	1.60	n/a	0.60	n/a	10	1.13	0.22
Urals Energy	Russia	UEN.L	GBP	0.09	25	1.0	0.07	4.2	n/a	48	n/a	6.35	1.38
Volga Gas	Russia	VGAS.L	GBP	2.36	315	94	5.0	69.1	2.0	605	40.1	3.78	1.25
Alliance Oil Company	Russia	AOIL.ST	SEK	99.48	2,419	10	4.8	6.1	2.9	159	79	5.47	4.10
Russia average						19.7	4.8	13.3	2.8	208.6	74.6	5.04	3.52
Regal Petroleum	Ukraine	RPT.L	GBP	0.65	334	117	4.4	41.1	1.8	339	64	1.26	0.62
Tethys Petroleum	Kazakhstan	TPL.TO	CAD	0.75	94	n/a	30.5	n/a	5.6	41	28	6.56	0.25
FSU Average						81	10.5	42	3.3	384	82.7	2.74	0.84
Russian discount/prem to FSU						-76%	-55%	-69%	-15%	-46%	-10%	84%	320%

* For companies with ratings Under Review (UR) or Restricted (R) EV is calculated based on last reported net debt. For all other companies 2009E net debt is used in the calculations.

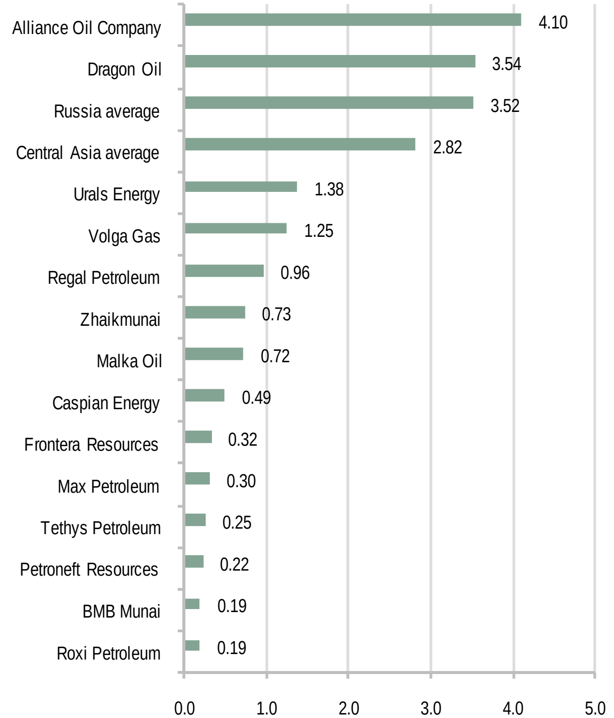
Source: Company data, Thomson Financial, Renaissance Capital estimates

Figure 8: EV/2P reserves valuations for FSU alternatives, $/boe



Source: Company data, Thomson Financial, Renaissance Capital estimates for companies from Figure 8, unless their ratings are Restricted

Figure 9: EV/Total resources valuations for FSU alternatives, $/boe



Source: Company data, Thomson Financial, Renaissance Capital estimates for companies from Figure 9, unless their ratings are Restricted

Figure 10: FSU M&A transactions

Date	Buyer	Target	Net consideration, $mn	Stake, %	Gross net debt, $mn	Gross 2P reserves, mn boe	Gross total resources, mn boe	EV/2P reserves, $/boe	EV/Total resources, $/boe
Feb 2003	Shell Kazakhstan Development	Mertvyi Kultuk + 50% in Arman + 1.75% in CPC	41	100		6.11	246	6.75	0.17
May 2003	CNPC	Actobemunaigas	150	25		822	822	0.73	0.73
Jun 2003	CNPC	North Buzachi	70	35		250	250	0.80	0.80
Aug 2003	CNPC	North Buzachi	130	65		250	250	0.80	0.80
Dec 2003	Nelson Resources	North Buzachi	90	50		250	250	0.72	0.72
2003			481	48		1,578	1,818	0.63	0.55
Oct 2004	Sinopec	First International Oil Company (FIOC)	160	85		25	25	7.53	7.53
Nov 2004	Nelson Resources	Chaparral Resources (36% in Karakuduk)	24	60	32	62	62	1.16	1.16
Dec 2004	Nelson Resources	Arman oil field (KazMunaiGas)	11	55		10.8	13	1.85	1.54
2004			195	80	32	98	100	2.81	2.75
Jan 2005	Arawak Energy	Altius Energy Corporation	48	100		27	27	1.8	1.8
Feb 2005	Victoria Oil and Gas	Feax Investments Company	15	100		13	13	1.2	1.2
Oct 2005	LUKOIL	Nelson Resources	1,091	58	89	270	270	7.3	7.3
Oct 2005	CNPC International	PetroKazakhstan	4,180	100	-144	503	503	8.0	8.0
Dec 2005	LUKOIL	Nelson Resources	1,951	100	89	270	270	7.6	7.6
2005			7,285	94	34	1,083	1,083	7.21	7.21
Jul 2006	NC KazMunaiGas	Petrokazakhstan	1,372	33	-144	463	463	8.7	8.7
Jul 2006	NC KazMunaiGas	KazGerMunai	1,092	50	-173	297	311	6.8	6.5
Aug 2006	CNPC E&D (PetroChina)	PetroKazakhstan	2,735	67	-144	463	463	8.5	8.5
Sep 2006	LUKOIL	Chaparral Resources	89	40	-24	61	61	3.3	3.3
Dec 2006	India Mittal Investments	Caspian investment resources	980	50	176	575	989	3.7	2.2
Dec 2006	CITIC Group	Nations Energy (95% in Karazhanbasmunai)	1,910	95	102	484	575	4.4	3.7
2006			8,178	63	-207	2,343	2,862	5.43	4.45
Jan 2007	NC KazMunaiGas	CITIC Canada Energy	955	48	102	274	365	7.6	5.7
Apr 2007	KazMunaiGas (KMG EP)	KazGerMunai	1,070	50		297	311	7.2	6.9
Apr 2007	CITIC Resources Hldg Ltd	Renowned Nation	1,004	48	101	274	365	8.0	6.0
Jun 2007	Arawak Energy	Saigak Investments	25	40		5.5	5.5	11.4	11.4
Aug 2007	Institutional investors	Tethys Petroleum	22	18		11	131	11.1	0.9
Nov 2007	Urals Energy	TAAS Yuriakh Neftegazodobycha	590	35.3		718	1,170	2.3	1.4
Dec 2007	KazMunaiGas (KMG EP)	CITIC Canada Energy	876	48	101	484	575	4.0	3.3
Dec 2007	ENI	Burren Energy	3,520	100	-379	232	361	13.5	8.7
2007			8,062	70	-75	2,296	3,284	4.99	3.49

Figure 10: FSU M&A transactions (continued)

Data	Buyer	Target	Net consideration, $mn	Stake, %	Gross net debt, $mn	Gross 2P reserves, mn boe	Gross total resources, mn boe	EV/2P reserves, $/boe	EV/Total resources, $/boe
Jan 2008	Petrolinvest	EmbayugNeft	71	50		1.24	18	n/a	7.9
Jan 2008	Petrolinvest	Capital Energy SA	128	100		50	111	2.6	1.2
Jan 2008	Petrolinvest	Occidental Resources	311	49			174	n/a	3.6
Feb 2008	Roxi Petroleum	Eragon Petroleum	196	59			30	n/a	11.1
Mar 2008	LUKOIL	CIS Holdings (South-West Gissar and Ustyurt fields in Uzbekistan)	778	100		274	595	2.8	1.3
May 2008	KNOC	Zhambyl field	85	27			252	n/a	1.2
Jun 2008	Jupiter Energy Ltd	North West Zhetybai	39	100		21	21	1.9	1.9
Aug 2008	ONGC	Imperial Energy	2,364	100	-220	920	1,558	2.3	1.4
2008			3,972	92	-220	1,266	2,759	2.44	1.49
Jan 2009	Vitol Group	Arawak Energy	146	100	41	62	89	3.0	2.1
Jan 2009	Sberbank	Dulisma and TAAS Yuriakh Neftegazodobycha	630	67		1,598	2,282	0.59	0.41
Feb 2009	Macquarie Bank	Max Petroleum	8	25	88	10	1,057	12.0	0.11
Jun 2009	National Reserve Bank	Timan Oil & Gas	102	48	50	191	609	1.37	0.43
Jun 2009	Emirates National Oil	Dragon Oil	1,363	48	-449	636	763	3.8	3.1
Sep-09	Itera	Sibneftegaz	134	21	590	1,833	2,480	0.67	0.50
Oct-09	China Investment Corporation	Noble Oil	300	45	0	150		4.44	n/a
2009			3,183	48	-106	4,480	7,281	1.44	0.89
Min								0.59	0.11
Max								13.54	11.36
Average			31,504	74	-542	13,253	19,743	3.10	2.13

Source: Company data, Bloomberg, Renaissance Capital estimates

Background

PetroNeft Resources is a public company, registered in Ireland, with a current market capitalisation of $103mn. The company was set up to develop oil assets in the Tomsk region, in Western Siberia, and was admitted to the London AIM and Dublin IEX Markets on 27 Sep 2006. Since then, the company's share price (see Figure 11) peaked at GBP0.64/share on 10 May 2007 and the stock is currently trading at a 72% discount to that level, with the minimum of GBP0.085/share passed through on 31 Dec 2008. Since its IPO, PetroNeft has issued new shares three more times raising $57.2mn in net proceeds. In July 2007 and over July-Aug 2008, PetroNeft completed two equity placements of 15.1mn and 34.5mn of new common shares (the second placement was in two tranches), raising $14.6mn at GBP0.5/share in 2007 and $16.5mn at GBP0.25/share in 2008 in net proceeds. The most recent issuance was completed on 21 Sep 2009, raising an additional $27.5mn ($26.1mn in net proceeds) at GBP0.14/share.

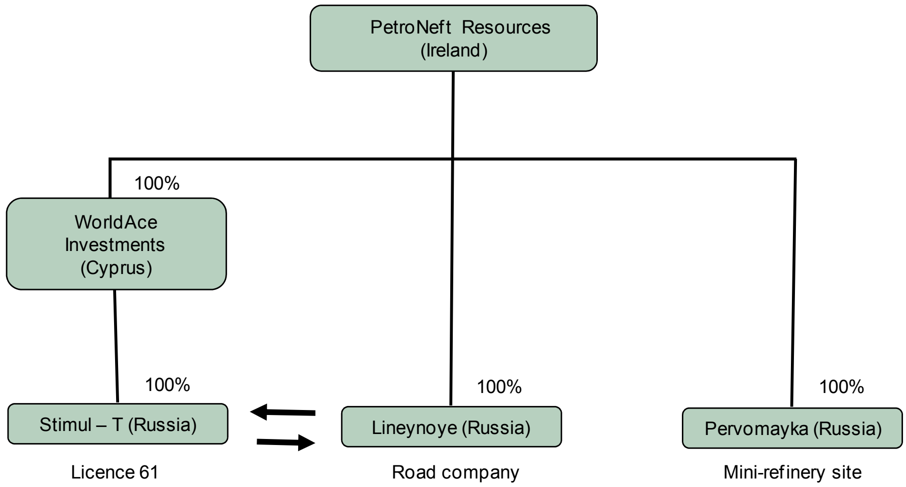
Figure 11: PetroNeft Resources price performance, GBP/share

Source: Thomson Datastream

The company has its origins in Texas-based PetroNeft LLC, which was established in 2003 as an oil and gas investment and consultancy company with a principal focus 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% interest in Licence 61 following a competitive auction process in the Nov 2004 Tomsk Licence Auction. PetroNeft Resources was incorporated on 15 Sep 2005 and, as part of a corporate reorganisation, acquired the principal assets and liabilities of PetroNeft LLC in Nov 2005.

PetroNeft's corporate structure is illustrated in Figure 12. Stimul-T is the key operating subsidiary holding the Tomsk oil licence, and WorldAce Investments (which owns 100% of Stimul-T) is a Cyprus-based holding company aiming at facilitating security arrangements with potential lenders (PetroNeft is debt-free at the moment). Lineynoye is a Tomsk-based construction company. Pervomayka is a property holding company that owns a 7.5 ha site in the Tomsk region for the construction of a mini-refinery with potential capacity of 100k tpa. PetroNeft bought this site in Dec 2007 for $186,000, and it has always regarded the acquisition as an option to get into the higher-margin downstream business after the start of commercial oil production on its licence area.

Figure 12: PetroNeft Resources corporate structure



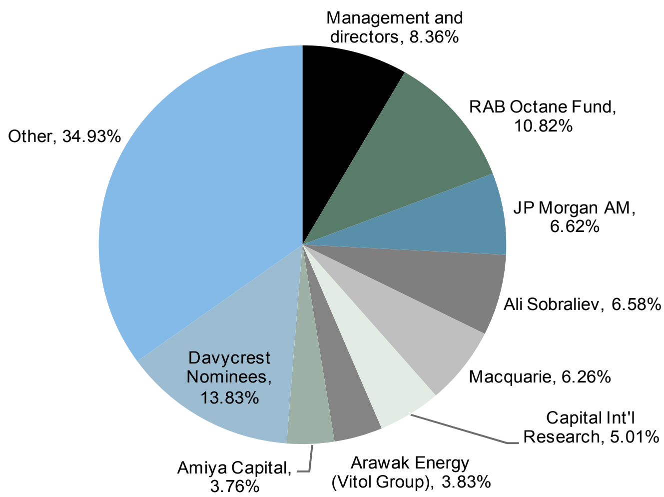
Source: Company data

Ownership

PetroNeft's charter capital is split into 349,863,243 common shares, of which 81.23% are in free float, on our estimates (see Figure 13). Management and directors hold 8.36% of all outstanding shares and 10.1mn of share options (see Figure 14), none of which is in-the-money at the moment. Ali Sobraliev, the son of PetroNeft's non-executive director Vakha Sobraliev, owns 6.58% of the charter capital. Jersey-registered Arawak Energy (with assets in Kazakhstan, Russia and Azerbaijan), which was recently acquired by Vitol Group, holds 3.83% of PetroNeft. In Aug 2008, PetroNeft entered into a strategic alliance with Arawak Energy to jointly pursue opportunities outside Licence 61 in Western Siberia. Although the parties have not made any significant advance in their cooperation, due to the economic crisis and Arawak's takeover, discussions are ongoing, and PetroNeft is leading the process of assessing and prioritising opportunities.

PetroNeft has a share-option plan, under which employees can receive conditional awards of share options depending on their performance, seniority and length of service. The options typically vest in four instalments, subject to vesting conditions, such as the company reaching pre-specified drilling, production or shareholder return milestones. The options' maximum validity period is seven years. As of Oct 2009, there were 10,072,000 options outstanding, of which over 4mn were exercisable at prices in the range of GBP0.28-0.40/share.

Figure 13: PetroNeft Resources' shareholders' structure (as of 26 Oct 2009)



Source: Company data

Figure 14: Management and directors ownership

Name	Position	Common shares as of 26 Oct 2009	% of charter capital	Share options as of 31 Dec 2008	Exercise price GBP/share
David Golder	Non-executive chairman	3,165,458	0.90%	495,000	0.36
Dennis Francis	CEO	22,409,045	6.41%	1,210,000	0.36
Paul Dowling	CFO	48,000	0.01%	575,000	0.36
David Sanders	General legal counsel, executive director	2,102,802	0.60%	1,160,000	0.36
Thomas Hickey	Independent non-executive director	1,535,057	0.44%	353,000	0.36
Vakha Sobraliev	Non-executive director	transferred all his shares (23,014,273) to his son, Ali	0.00%	475,000	0.36
Total		29,260,362	8.36%	4,268,000	

Source: Company data

Corporate governance

PetroNeft has an established track record with UK/Irish corporate governance requirements, and provides a high level of disclosure to its shareholders.

PetroNeft's board comprises three executive directors and three non-executive directors. It is responsible for formulating, reviewing and approving the company's strategy, budgets, major capex items and acquisitions. PetroNeft has audit and remuneration committees with formally delegated duties and responsibilities; both committees comprise the three non-executive directors: David Golder, Thomas Hickey and Vakha Sobraliev.

All members of the company's board of directors are highly experienced professionals in international and Russian oil exploration and development, and its Russian management team has extensive local knowledge. In particular, Dennis Francis, David Sanders and David Golder were instrumental in setting up Sakhalin Energy and launching the first ice-resistant platform offshore Sakhalin. This was the only major foreign project going forward in Russia in the 1990s, and it has received praise from many Russian government officials. Alexander Frenovsky and Nikolay Karapuzov worked, for many years, for Tomskneftegazgeologia, which discovered and delineated almost all the oil and gas fields in the Tomsk region. Both have received honours from the Russian government for their contributions to the development of the subsurface in the Tomsk region. We provide detailed profiles of PetroNeft's directors and management below.

Board of directors

David Golder: Non-executive chairman

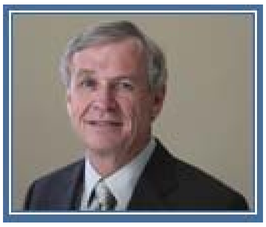
Golder (age 61) has been non-executive chairman of the company since 2005. He is also chairman of the remuneration committee and a member of the audit committee. He has more than 38 years' experience in the petroleum industry and was formerly senior vice president of Marathon Oil Company (Marathon), retiring in 2003. From June 1996 until 1999, Golder worked for Sakhalin Energy Investment Company, where he was executive vice president – upstream. Located in Moscow, he focused on the oil development and infrastructure aspects of the Sakhalin II Project. In addition, he managed the $650mn development of the Piltun-Astokhskoye oilfield and associated infrastructure. He was also co-chairman of the joint supervisory board that oversaw the Sakhalin II production-sharing agreement. Golder is currently president of David Golder Consulting and a member of the Society of Petroleum Engineers. He holds a BSc degree in petroleum and natural gas engineering from Pennsylvania State University, and has completed a Programme for Management Development at Harvard University.

Dennis Francis: CEO, executive director

Francis (age 60) has been CEO and an executive director of the company since its formation in 2005. He has more than 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. Marathon and its partners ultimately won the first Russian competitive tender to develop the Sakhalin II project, offshore Sakhalin Island. Francis managed the implementation of this project within Marathon. He also was a director on the board of Sakhalin Energy Investment Company during the Phase I project development. Francis received 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 holds a BSc degree in geophysical engineering and an MSc degree in geology, both from the Colorado School of Mines. He has completed the Programme for Management Development at Harvard University.

Dr David Sanders: General legal counsel, executive director, company secretary



Dr Sanders (age 60) has been general legal counsel, executive director and company secretary since PetroNeft's formation in 2005. He is an attorney of law and has more than 32 years' experience in the petroleum industry, including 14 years doing business in Russia and three at the oil and gas litigation division of the law firm Fulbright & Jaworski LLP. In 1988, Sanders joined Marathon, where he analysed and reviewed joint venture agreements until his appointment, 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 for Marathon's CIS joint ventures group, and later became the lead negotiator for Russian projects at Marathon's commercial and negotiations group. Sanders holds 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

Dowling (age 37) joined PetroNeft in Oct 2007, and was appointed to the board of directors on 29 Apr 2008. He has 17 years' experience in banking, accounting, auditing, taxation, financial reporting, AIM/IPO reporting, corporate restructuring, corporate finance and acquisitions/disposals. Most recently he was a partner at LHM Casey McGrath, in Dublin. 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 ACCA at the Consultative Committee of Accountancy Bodies - Ireland.

Thomas Hickey: Independent non-executive director

Hickey (age 40) 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. Hickey was CFO and a director of Tullow Oil over 2000-2008. During this time Tullow expanded through a number of significant acquisitions, including more than GBP400mn of assets acquired in the North Sea, the $570mn acquisition of Energy Africa in 2004 and the $1.1bn acquisition of Hardman Resources in Jan 2007. Prior to joining Tullow Oil, Hickey was an associate director at ABN AMRO Corporate Finance (Ireland), which he joined in 1995. In this role, he consulted public and private companies on fund raising, stock-exchange requirements, mergers and acquisitions, flotations and related transactions. 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 Oil is a significant minority shareholder.

Vakha A Sobraliev: Non-executive director

Sobraliev (age 54) has been a non-executive director of the company since 2005. He is a member of both the audit and remuneration committees. He has more than 30 years' experience in running oilfield services companies in the Western Siberian basin. Sobraliev is currently a shareholder and general director of drilling company, Tomskburneftegaz, which owns more than 15 exploration and development drilling rigs, as well as mechanical repair facilities. From 1975 to 2000, Sobraliev worked for Tomskneft and Strezhevoy Drilling Boards in various roles, including chief engineer and chief accountant. He holds degrees in mining engineering and economics from Tomsk Polytechnic Institute and the Tomsk State University, respectively. Sobraliev is a resident of Tomsk.

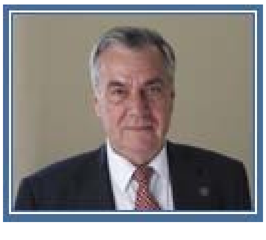
Key management of Stimul-T

Alexey Balyasnikov: General director, Stimul-T

Balyasnikov (age 62) has more than 32 years' experience in the Russian oil and gas industry. He worked for Marathon in various roles, including head of its representative office in Moscow from 1990 to 2004. Most recently he has worked for PetroNeft on numerous tasks, including a large due diligence project for TNK-BP in Western Siberia. Prior to joining Marathon, Balyasnikov was a senior geophysical researcher for the Moscow Research Institute. He holds a degree in geophysics from St. Petersburg University. He is a native Russian speaker, and fluent in English.

Alexander Frenovsky: Managing director, Stimul-T

Frenovsky (age 61) is a former general director and chief engineer of Tomskneftegazgeologia. Frenovsky has more than 34 years' experience in the oil industry and received a state medal *For Development of the Subsurface and Oil and Gas Industry of West Siberia* and the *Merited Worker of Geological Exploration* badge of honour. He has participated in the discovery of fields in the Tomsk region and taken part in the development of over 15 oilfields. Frenovsky graduated in 1971 from the Oil University in Ufa, with a specialisation in drilling oil and gas wells.



Dr Nikolay Karapuzov: Chief geologist and geophysicist, Stimul-T

Dr Karapuzov (age 63) is a former chief geophysicist/chief geologist at Tomskneftegazgeologia, where he had worked for 35 years and directly participated in the discovery of 17 oilfields. He has been awarded the title *Honourable Geologist of Russia* by the Russian government for his contribution to the development of the subsurface in the Tomsk region. Karapuzov graduated from Voronezh State University in 1970 with a specialisation in geophysical methods of hydrocarbon exploration.

Assets

Tomsk region

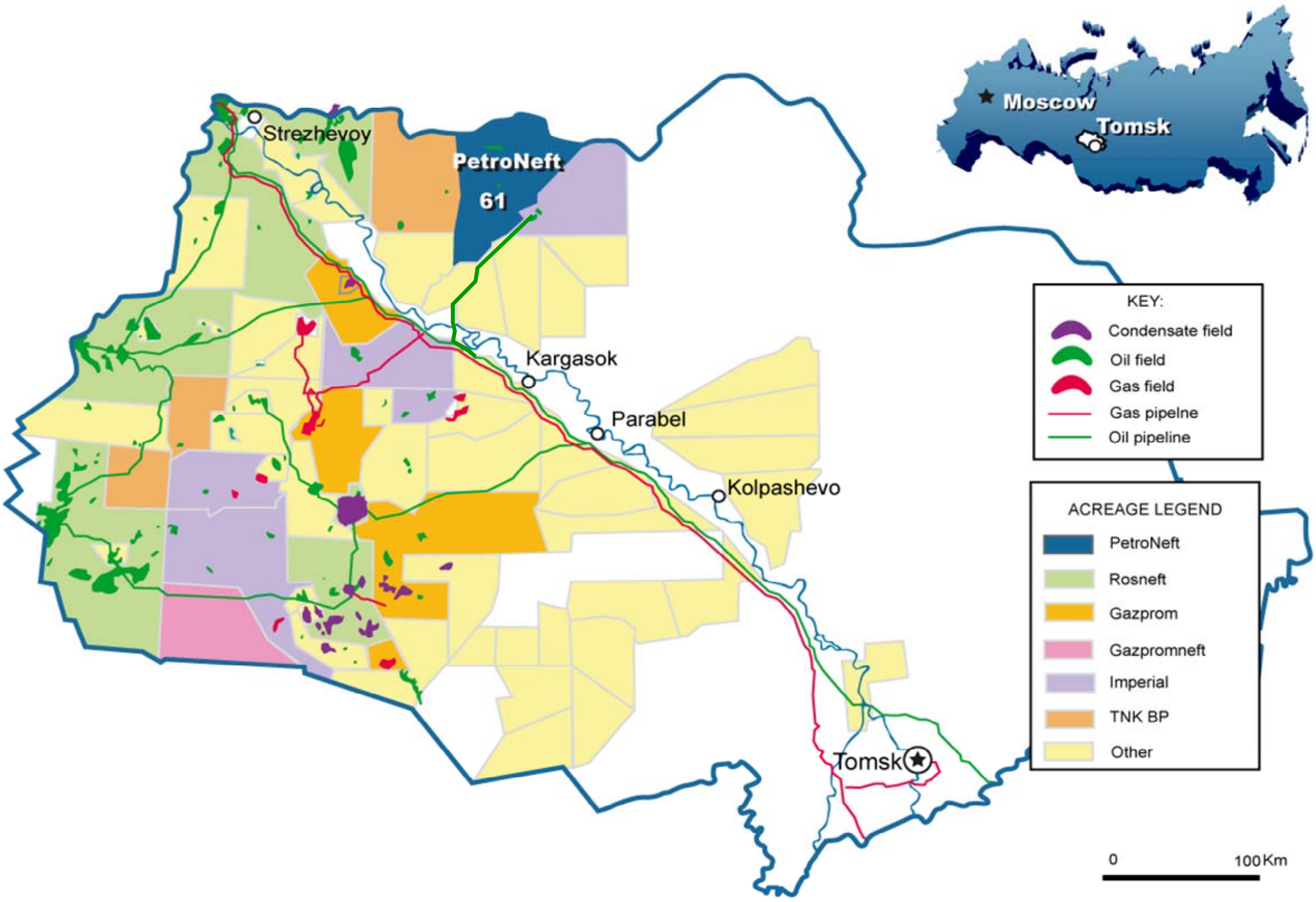
The Tomsk region lies in the south-eastern part of West Siberian plain. The West Siberian oil and gas basin is the largest oil and gas basin in the world in terms of area (3.4mn km2) and the second largest to the Middle East in terms of reserves (144bn bbls of oil and 36.4tcm of gas). The region is characterised by waterlogged soils, shallow lakes and extensive swamps. Winters are severe and last seven-to-nine months, with mean temperatures ranging from about -15º C to -30º C. These winter conditions support better access to oilfields, particularly in newer areas of development with negligible infrastructure. Approximately 70% of Russia's oil production comes from the West Siberian basin.

The structure of the Jurassic Cretaceous strata of the West Siberian basin is a gentle depression superimposed on various Paleozoic structures and early Triassic Rifts. The largest oil reserves are concentrated in the core of the basin, primarily in stacked reservoirs of Necomian age overlying the Bazhenov Formation. The Upper Jurassic rocks, PetroNeft's main target horizon, immediately below the Bazhenov Formation, are also oil rich.

The Tomsk region has large reserves of natural resources and raw materials. Its oil reserves (267mnt of ABC1 reserves and 1,800mnt of resources) may rival those of Gabon and Syria, while gas reserves (285bcm of ABC1 reserves and 970bcm of resources) are comparable with those of Peru and Great Britain. There are also 33mnt of ABC1 reserves and 200mnt of resources of gas condensate in the region. Prospective oil- and gas-bearing areas account for 72% of the region, however, of the 118 discovered fields, only one is large (Myldyzhynskoye). With production of approximately 205kbopd and 4.3bcm of gas per year, oil accounts for about 60% of exports from the region. Oil production is carried out mainly in the north-west and in the north of the region (where the depletion rate of the fields is already about 50%), while the east of the Ob River area (where PetroNeft's licence is located) is underexplored and has significant exploration potential, according to the Russian Science Academy, whose geologists estimate that potential oil resources of this area may range between 600mnt and 1,000mnt. Due to the lack of development activities, the infrastructure in the eastern area is almost absent. The long-term hydrocarbons production prospects of the Tomsk region are fully dependent on the development of the eastern area, as production from the majority of all discovered properties is expected to start declining from 2013-2015, in accordance with the *Concept of oil and gas industry development in the Tomsk region until 2030* (approved in 2002).

Apart from PetroNeft, licence holders in the Tomsk region include Gazprom neft, Rosneft, TNK-BP, Gazprom, Russneft, Imperial Energy (ONGC), Alliance Oil Company, Malka Oil and others (see Figure 15).

Figure 15: Oil and gas licence holders in the Tomsk region



PetroNeft's portfolio

PetroNeft's only asset is its 100% ownership of Stimul-T, the sole licence holder of the 4,991.8 km2 Licence 61 (Tungolsky), located in the Tomsk region of Russia. As shown in Figure 15, Licence 61 is located in the north-west of the Tomsk region, in the Alexandrov administrative district, in the prolific West Siberia oil basin, approximately 110 km from the giant Samotlor field (which contained about 3bnt of recoverable reserves when it was discovered in 1965).

The eastern boundary of the area coincides with the administrative border between the Alexandrov and Kargasok districts. The distance from the block boundary to the nearest main oil pipeline (Strezhevoy-Tomsk) is 60 km. The distance to the nearest surfaced road is 90 km. A high-voltage power transmission line runs parallel to the oil pipeline. Seismic acquisition and exploration drilling activities take place in the winter months.

Asset history

PetroNeft's Licence 61 (Tungolsky) was issued by the Federal Agency for Subsoil Use to the company's subsidiary Stimul-T for the geological survey, exploration and production of hydrocarbons at the Tungolsky area on 4 May 2005, and is valid until 15 Apr 2030.

Reserves structure and exploration potential

Ryder Scott, in its Petroleum Consultants Report (PCR) dated 31 Dec 2008, identified the licence area as holding 70.0mn bbls of proved and probable reserves, as well as 269.4mn bbls of risked possible reserves and 14.9mn bbls of risked resources for a total of 354.4mn bbls, as summarised in Figure 16. These estimates comply with PRMS standards.

Figure 16: PetroNeft's reserves and resources as of 31 Dec 2008, mn boe

Assets	Proved reserves	Probable reserves	2P reserves	Risked possible reserves	3P reserves	Risked resources	Total
Lineynoye field	5.69	18.13	23.82	4.83	28.65		28.65
West Lineynoye field	2.71	20.59	23.30	5.90	29.19		29.19
Tungolskoye field	1.42	13.36	14.77	4.14	18.91		18.91
Kondrashevskoye field	0.39	7.72	8.11	17.99	26.10		26.10
Sub-total for fields	10.20	59.80	70.00	32.85	102.85	0.00	102.85
Upper Jurassic - 25 prospects and four leads				116.54	116.54	14.93	131.47
Cretaceous - nine prospects				92.86	92.86		92.86
Lower to Middle Jurassic - 11 prospects				27.20	27.20		27.20
Total	10.20	59.80	70.00	269.45	339.45	14.93	354.38

Source: Ryder Scott reserves report

The PCR states that Licence 61 is located in the south-eastern part of the West Siberian Platform. The basement for this platform is the Paleozoic rock sequence, overlaid by the Mesozoic-Cenozoic sedimentary cover. Lower Mesozoic (Triassic) units are identified in the trough areas between the basement and the Middle Mesozoic/Cenozoic cover.

More than 30 Upper Jurassic structures have been identified in the licence area. Deep wells have been drilled on nine structures, and four oilfields have been discovered in the deposits of the Upper Jurassic sedimentary cover (the Lineynoye, Tungolskoye, West Lineynoye and Kondrashevskoye [Korchegskaya] oilfields). The reported proved and probable reserves relate to these four fields.

In addition, further prospects have been identified in both the Upper Jurassic and other horizons, and included in the possible reserves category. These are:

- Twenty-five major structures or groups of structures that are well defined four-way dip structural closures at the Upper Jurassic Reservoir interval (Base Bazhenov seismic horizon). Importantly, PetroNeft believes the Traverskaya prospect may be a western extension of the Kiev-Eganskoye oilfield (located in the neighbouring Licence 80 to the east of Licence 61), where a series of discoveries were announced by Imperial Energy in 2007-2008.

- Nine prospects in the Cretaceous horizon also classified as possible reserves, because multiple seismic lines confirm four-way dip closure of the structures at the Lower Cretaceous II-BI seismic horizon. This horizon represents additional interest following the successful testing of bypassed Lower Cretaceous pay (1,575 bopd) in the Kiev-Eganskoye No. 361 well, as reported by Imperial Energy on 2 June 2008.

- Eleven Lower to Middle Jurassic prospects classified as possible reserves because multiple seismic lines confirmed four-way dip closure of the structures at the Middle Jurassic seismic horizon. The probability distribution functions of the other volumetric parameters, including net pay, were based on data from a report prepared by Tomsk Geophysical Company LLC (TGK) in 2008 regarding the *Re-interpretation of Geological and Geophysical data for Exploration Wells*. TGK interpreted potential bypassed Lower to Middle Jurassic pay in the Traverskaya No. 1, Tuganskaya No. 1 and West Korchegskaya No. 1 wells, in Licence 61. Lower to Middle Jurassic sandstones have successfully tested oil in the Vartovskoye No. 330 well (648 bopd) and the Tolparovskaya No. 1 well (15 bopd) in adjacent blocks to the west and south of Licence 61.

The PCR also identified four structures in the Base Bazhenov horizon belonging to the *potential prospect* category. These structures require additional seismic data to confirm structural closure, and have been listed as resources.

Work programme

Pursuant to the licensing agreement, Stimul-T has a number of obligations with regard to the exploration and production of hydrocarbons, including:

- Carrying out of 1,000 km of 2D seismic studies within three years from the date the licence is registered.

- Drilling no fewer than six exploration wells within six years from the date the license is registered.

- Commencing production on the Tungolsky area no later than two years from the date of approval of the reserves (Dec 2008).

PetroNeft has already met its seismic obligation by acquiring a total of 1,055 km of new, high-resolution 2D seismic during the winter seasons 2005/2006 and 2006/2007. PetroNeft has also now drilled the six required wells and met all the exploration drilling requirements for the term of the licence. PetroNeft produced marginal volumes of oil in the winters of 2008 and 2009, technically meeting the production requirement of the licence; however, commercial oil production should start only in 2010, subject to the crude-evacuation infrastructure being in place.

Over 2008, PetroNeft funded the drilling of two exploration wells and one delineation well, well testing, geological and geophysical studies, feasibility and development studies, and the acquisition of 65 km of 273-mm diameter pipe for the export pipeline (see more details below). Both the West Lineynoye delineation well and the Korchegskaya exploration wells have been successful in finding oil in the primary target of Upper Jurassic sandstone. While the primary Jurassic reservoir objective was absent in the West Korchegskaya exploration well, a 25-metre sandstone interval, with hydrocarbon potential, has been identified in the Lower Jurassic secondary objective. However, development activities were suspended in Oct 2008, due to the financial crisis and the board's decision to focus on cash preservation and capex optimisation. Following the successful equity issuance in Sep 2009, raising $26.1mn of net proceeds, the company has now restarted its development programme and is fully funded to reach year-round production in 3Q10.

The company's current work programme, designed to cover identified 2P reserves, envisages the construction of the export pipeline, the drilling of 151 oil production wells and the building of associated infrastructure, for a total cost of $334.6mn, according to our estimates.

There are currently three exploration rigs at PetroNeft's sites, and a production rig in storage close to the licence area. The company believes it will require one production rig in 2010, two rigs in 2011 and three rigs in 2012. PetroNeft notes good rig availability in the region. According to the company, tenders for the drilling of nine development wells in 2010 have been received and are currently being evaluated. Initial indications are that drilling costs will be within budget estimates. We expect the drilling contract will be awarded and signed by the end of 2009.

Infrastructure and offtake

On 26 Aug 2009, PetroNeft entered into a crude oil transportation and custody transfer agreement with Imperial Energy (a 100% subsidiary of ONGC). Under the terms of the agreement, Imperial will accept PetroNeft's crude oil using existing tank facilities at the Kiev-Eganskoye field and transport the crude to its custody transfer point at Zavyalovo for transfer into the Transneft system. The agreement is effective for 25 years and the tariff (undisclosed) is subject to adjustments based on the Russian Consumer Price Index.

PetroNeft has already signed a fixed-price contract for the construction of a 60 km pipeline from its Lineynoye oil field to the Kiev-Eganskoye oil field. PetroNeft has held 65 km of pipe in storage, which is currently being transported by barge from the storage location to a staging point south of Licence 61, so that the pipeline construction could start in Jan 2010.

Once the pipeline infrastructure is in place, year-round production can start, with crude being sold domestically or exported through Transneft pipelines.

Strategy and risks

PetroNeft's strategy is to develop its oil business in Russia, using the combined skills, experience and resources of the company's directors and employees. In the short term, it aims to achieve this by rapidly bringing the existing discoveries into production, and exploiting the additional exploration opportunities already identified and summarised in the Ryder Scott report.

In addition to operations on Licence 61, the company continues to evaluate new acquisition projects. The objective here is to acquire new exploration and production areas that satisfy the company's strict technical and legal criteria. While the main focus for new acquisitions will be the Western Siberian basin, the company will also consider projects in other areas of Russia.

We regard PetroNeft's strengths as the following:

- After the successful completion of its capital raising in Sep 2009, the company is fully funded and can start building the pipeline necessary to start commercial production of crude.
- Both its board of directors and local management team have significant experience and successful track records in the Russian oil industry.
- The company maintains a high level of corporate governance, typical of UK/Irish-listed companies.
- The minimum working programme required by the licence terms is complete.
- PetroNeft has received high-quality 2D seismic results.
- Drilling rigs are readily available in the region.

We note that PetroNeft exposes investors to a number of risks. Our main areas of concern are the following:

- We believe the company's shareholder base is too diversified for a small operator, lacking a single strategic investor.
- It is a small company, focused on the hydrocarbon industry in Russia, which exposes potential investors to significant volatility risk.
- Execution risk, typical for early-stage oil development companies.

Financial review

Financial and operating forecasts

Our operational and financial forecasts for PetroNeft are set out in Figure 17. Our key assumptions are detailed below.

We expect PetroNeft to start commercial oil production in 2010 at an average level of 2.7kboepd, which we expect to grow to 18.8kboepd by 2014 (a CAGR of 62%) before starting to decline. We assume this crude will be sold domestically at an average price of $34.3/bbl in the long term, which is equivalent to our long-term Brent price forecast of $80/bbl. In 2010, we expect an average Brent price of $70/bbl, which should translate into a domestic realised price for PetroNeft of $30.8/bbl, on our estimates. These assumptions lead us to believe PetroNeft will generate $31mn of revenues in 2010, and the top line will reach $236mn in 2014 (a CAGR of 66%).

Our operating cost estimates include lifting costs, transportation charges and mineral extraction tax (MET). We expect PetroNeft's lifting costs to grow from $1.2/bbl in 2010 to $4.4/bbl in 2020 (a CAGR of 14%). We assume constant unit transportation costs of $2/bbl in the long term. MET in Russia is linked to the oil price, therefore given our stable long-term oil price forecast, it is also relatively stable in our model, growing from $11.6/bbl to $13.3/bbl in the long term.

Our operating assumptions for PetroNeft yield a decent EBITDA margin of about 45%, on average, over 2010-2020E. Accordingly, our net income estimate increases from $8.7mn in 2010 to $89.2mn in 2014 (a CAGR of 79%).

Figure 17: PetroNeft Resources – Operational and financial forecasts, $mn (unless stated otherwise)

	2007	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E
Total hydrocarbon production, kboe	-	-	-	1,003	3,405	4,896	6,089	6,873	5,993	5,906	5,195	3,969
Total hydrocarbon production, kboepd	-	-	-	2.7	9.3	13.4	16.7	18.8	16.4	16.2	14.2	10.9
Domestic oil price (without VAT), $/bbl	32.2	39.3	30.9	34.4	34.4	34.3	34.3	34.3	34.3	34.3	34.3	34.3
Sales	-	-	-	31	117	168	209	236	205	202	178	136
Operating costs	-	-	-	16.6	55.5	80.7	101.3	115.4	103.1	103.2	93.3	72.7
SG&A	3.4	3.4	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
DD&A	0.04	0.2	0.3	1.4	3.5	6.7	10.0	12.9	15.4	18.2	20.3	20.9
Other	0.8	-	-	-	-	-	-	-	-	-	-	-
EBIT	(4.2)	(3.6)	(3.3)	10.1	55.0	78.1	94.7	104.4	83.8	78.0	61.3	39.3
EBITDA	(4.2)	(3.4)	(3.0)	11.5	58.5	84.8	104.7	117.3	99.2	96.2	81.6	60.3
EBITDA margin, %	*neg*	*neg*	*neg*	*37%*	*50%*	*50%*	*50%*	*50%*	*48%*	*48%*	*46%*	*44%*
Interest (expense)/income	0.5	0.1	1.1	0.8	1.5	2.4	4.3	7.1	9.6	11.8	14.2	17.0
Other non-operating (expenses)/income	0.8	(4.2)	-	-	-	-	-	-	-	-	-	-
Pre-tax income	(3.0)	(7.7)	(2.1)	10.8	56.5	80.5	99.0	111.5	93.4	89.8	75.5	56.4
Income tax	0.3	0.2	(0.4)	2.2	11.3	16.1	19.8	22.3	18.7	18.0	15.1	11.3
Net income	(3.2)	(7.9)	(1.7)	8.7	45.2	64.4	79.2	89.2	74.7	71.8	60.4	45.1

Source: Company data, Renaissance Capital estimates

Investment programme and funding

PetroNeft undertook $18mn of capex in 2007, and $25.5mn in 2008. In 2009-2018 it will require an additional $335mn of investment to achieve its operational targets, on our estimates, with capex peaking in 2013 ($52.4mn). We detail our capex forecasts in Figure 5. According to our estimates, PetroNeft's capex requirement until 31 Dec 2010 is $21.9mn. These funds are necessary to provide for crude-evacuation infrastructure and finance the start of commercial crude production.

Thanks to the successful capital raising undertaken in Sep 2009, the company presently has a cash position of $27.4mn (including the 30 June 2009 cash balance of $1.3mn) and is fully funded. Once the pipeline infrastructure is in place, we estimate PetroNeft will be capable of financing its development from its own operating cash flows.

Disclosures appendix

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