

# PetroNeft

## Oil & Gas

### Looking beyond initial production

**Closing Price:** £0.66

**Price Target:** £0.77

**BUY**

- Mix of 'good and bad' in Operations Update...** - While significant detail was devoted in the PetroNeft update yesterday to forthcoming drilling activity, the market, not surprisingly, took its cue from the production shortfall, as reflected in the 10% decline in the share price. At face value, a year-end rate of 2,750 bopd, compared to a target of 4,000 bopd, represents a wide margin, but needs to reflect the fact that production only commenced at the end of August. Rationalising the outcome, management pointed to: (i) formation damage, as a result of production drilling last year; and (ii) the fact that two of the planned eleven wells failed to contribute for technical reasons. Had those additional wells been included management estimates that the year-end rate would have exceeded 3,000 bopd and in spite of the production shortfall, guidance for 2011 and 2012 has been maintained. That, along with the pending start of the 'fracking' programme (from mid-January to early March) provides a degree of confidence, albeit that the lower base entering the year places greater emphasis on a successful 'fracking' campaign.
- ...leads us to pull-back FY11 production, but maintain NAV...** - Taking our cue from production entering the year, we have tempered FY11 production from 8.0 kbopd to 7.1 kbopd, but maintained our profile beyond 2011 to reflect the potential to emerge from further exploration activity in Licence 61 and indeed the start of drilling on Licence 67. In total, 20 wells are planned for the coming year in Licence 61 (17 production and 3 exploration), with a further two exploration wells scheduled for the more recently acquired Licence 67. With an additional prospect (North Varyakhskaya), targeting 6 mmbbls net to PetroNeft, added to the 2011 campaign, the adjustment to our Total NAV (76.9p v 78.0 previously) and our revised price target of 77p is at the margin.
- ...amid ample potential catalysts in FY11** - Despite the apparent 'teething' issues, associated with production, we see no reason, as yet, to alter our positive view. That takes its cue as much from the ability of management to boost reserves, organically through exploration, and through future acquisitions, as it does from the trend in production, which, to date, is limited. With no apparent shortage of opportunities to enhance reserves amid a five well exploration campaign in 2011, we maintain our Buy recommendation.

	Mkt Cap			\$425m
<b>Financial Summary (Stg \$m)</b>				
Year Ending	Dec-09	Dec-10f	Dec-11f	Dec-12f
Sales	0.5	13.6	154.4	297.5
<b>Operating Profit</b>	<b>-3.8</b>	<b>-8.3</b>	<b>43.1</b>	<b>94.7</b>
Goodwill	0.0	0.0	0.0	0.0
Other Income	-0.9	-1.4	0.0	0.0
Associates / JV	0.0	0.0	0.0	0.0
Exceptionals	-1.6	-1.2	0.0	0.0
<b>EBIT</b>	<b>-6.3</b>	<b>-10.9</b>	<b>43.1</b>	<b>94.7</b>
Net Interest	0.2	-0.2	1.2	2.1
<b>PBT</b>	<b>-6.2</b>	<b>-11.0</b>	<b>44.3</b>	<b>96.9</b>
Tax	-0.3	2.0	-8.9	-19.4
<b>Attributable Profit</b>	<b>-6.5</b>	<b>-9.1</b>	<b>35.5</b>	<b>77.5</b>
EBITDAe	-4.5	-2.5	52.7	107.6
Net Debt	-15.7	-26.1	-34.7	-67.9
<b>Per share Analysis (p)</b>				
Adjusted EPS	-1.9	-2.2	8.4	18.3
Operating Cashflow	-1.0	-2.2	13.2	25.5
DPS	0.0	0.0	0.0	0.0
<b>Profitability (%)</b>				
Operating Margin	0.0	-61.2	27.9	31.8
ROAE	-7.7	-8.2	26.9	37.0
<b>Momentum (%)</b>				
Sales	0.0	2574.0	1032.5	92.8
EBITDA	-42.1	-45.6	-2233.4	104.3
Adjusted EPS	-49.6	12.5	-487.1	118.5
<b>Financing</b>				
Debt/Equity (%)	0.0	-37.1	-35.6	-48.0
Interest Cover (x)	0.0	0.0	0.0	0.0
<b>Valuation (x)</b>				
P/E	n/m	n/m	12.3	5.6
Dividend Yield (X)	0.0	0.0	0.0	0.0
EV/EBITDA	n/m	n/m	4.3	1.8
P/NAV	4.1	3.8	3.2	2.0
<b>Price Performance</b>				
<b>52 Week</b>		<b>Tickers</b>		
High	73.5	Reuters	PTR.L	
Low	20	Bloomberg	PTR LN	
<b>Absolute Price Change(%)</b>		<b>FTSE Oil&amp;Gas Rel. Price Change(%)</b>		
QTD	-6.1	QTD	-9.4	
YTD	-6.1	YTD	-9.4	

#### PetroNeft Vs FTSE AIM Oil & Gas



## PetroNeft - Forecast Changes

Year Ending (Dec)	2011			2012		
	Old	New	% Change	Old	New	% Change
<b>Group Sales</b>	<b>173.3</b>	<b>154.4</b>	<b>-11%</b>	<b>301.2</b>	<b>297.5</b>	<b>-1%</b>
Operating Costs	-107.5	-96.0	-11%	-186.2	-183.9	-1%
DD&A	-9.6	-9.6	0%	-12.9	-12.9	0%
Over/under-lift	0.0	0.0		0.0	0.0	
Administration	-5.7	-5.7	0%	-6.0	-6.0	0%
Other Income	0.0	0.0		0.0	0.0	
<b>Operating Profit</b>	<b>50.5</b>	<b>43.1</b>	<b>-15%</b>	<b>96.1</b>	<b>94.7</b>	<b>-1%</b>
Exceptional Gain	0.0	0.0		0.0	0.0	
EBITDA	60.1	52.7	-12%	109.0	107.6	-1%
Net Interest	1.7	1.2	-30%	2.8	2.1	-24%
Hedge Loss	0.0	0.0		0.0	0.0	
PBT	52.2	44.3	-15%	99.0	96.9	-2%
Tax	-10.4	-8.9	-15%	-19.8	-19.4	-2%
<b>Attributable Profit</b>	<b>41.8</b>	<b>35.5</b>	<b>-15%</b>	<b>79.2</b>	<b>77.5</b>	<b>-2%</b>
Per share Analysis (p)						
FRS3 EPS	10.1	8.6	-15%	19.2	18.7	-2%
FD EPS	9.9	8.4	-15%	18.7	18.3	-2%
<b>Adjusted EPS</b>	<b>9.9</b>	<b>8.4</b>	<b>-15%</b>	<b>18.7</b>	<b>18.3</b>	<b>-2%</b>

Source: Goodbody Stockbrokers

## PetroNeft Price/Forex Assumptions

	2010	2011	2012
New Oil Price - (\$/barrel)	79.20	85.00	85.00
Old Oil Price - (\$/barrel)	76.36	80.00	80.00
New \$/£ Exchange Rate	1.54	1.55	1.55
Old \$/£ Exchange Rate	1.52	1.42	1.60

Source: Goodbody Stockbrokers

## PetroNeft NAV Calculation

	W.I. Reserves mmboe	Risk Weighting	NAV \$m	NAV/Share p	Unrisked \$m	Unrisked p
<b>Risk Development</b>						
<i>Licence 61</i>						
Lineynoye	23.9	70%	116.2	17.3	166.0	29.1
West Lineynoye	23.3	70%	113.5	16.9	162.1	28.4
Tungolskoye	15.5	70%	75.5	11.2	107.8	18.9
Kondrashevskoye	8.1	70%	39.5	5.9	56.5	9.9
(Licence 61) Total			344.7			
<b>Risk Dev NAV</b>	<b>70.8</b>		<b>344.7</b>	<b>51.2</b>	<b>492.4</b>	<b>86.4</b>
<b>Less Net Debt</b>			26.1	3.9		3.9
<b>Total Core NAV (pence)</b>			<b>370.8</b>	<b>55.1</b>		<b>90.3</b>
<b>High Risk Exploration</b>						
<i>Licence 61</i>						
Upper Jurassic	74.5	30%	106.5	15.8	355.0	62.3
Cretaceous	31.2	10%	14.0	2.1	139.7	24.5
Lower - Middle Jurassic	12.6	10%	4.7	0.7	46.9	8.2
<i>Licence 67</i>						
Ledovy	45.0	10%	21.4	3.2	213.5	39.6
<b>High Risk Explor NAV</b>	<b>163.3</b>		<b>146.5</b>	<b>21.8</b>	<b>755.0</b>	<b>134.6</b>
<b>Total NAV</b>			<b>517.3</b>	<b>76.9</b>		<b>224.9</b>

Source: Goodbody Stockbrokers

	Mkt Cap (\$m)		262.60			
	Mkt Cap (£m)		169.42			
<b>PetroNeft</b>						
<b>Financial Overview (\$m)</b>						
Year Ending	Dec-08	Dec-09	Dec10f	Dec11f	Dec12f	Dec13f
<b>Group Sales</b>	<b>0.0</b>	<b>0.5</b>	<b>13.6</b>	<b>154.4</b>	<b>297.5</b>	<b>390.6</b>
Cost of Sales	0.0	-0.4	-17.0	-105.5	-196.8	-257.1
<b>Gross Profit</b>	<b>0.0</b>	<b>0.1</b>	<b>-3.4</b>	<b>48.8</b>	<b>100.7</b>	<b>133.5</b>
Administration Expenses	-3.6	-3.9	-5.0	-5.7	-6.0	-6.3
Exploration Write Off	0.0	0.0	0.0	0.0	0.0	0.0
<b>EBITDA</b>	<b>-7.8</b>	<b>-4.5</b>	<b>-2.5</b>	<b>52.7</b>	<b>107.6</b>	<b>143.0</b>
<b>Operating Profit (ex Goodwil</b>	<b>-3.6</b>	<b>-3.8</b>	<b>-8.3</b>	<b>43.1</b>	<b>94.7</b>	<b>127.2</b>
Goodwill Write-off	0.0	0.0	0.0	0.0	0.0	0.0
Other Income	-4.2	-0.9	-1.4	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	-1.6	-1.2	0.0	0.0	0.0
<b>EBIT</b>	<b>-7.8</b>	<b>-6.3</b>	<b>-10.9</b>	<b>43.1</b>	<b>94.7</b>	<b>127.2</b>
Interest Income / (Expense)	0.1	0.2	-0.2	1.2	2.1	4.3
<b>PBT</b>	<b>-7.7</b>	<b>-6.2</b>	<b>-11.0</b>	<b>44.3</b>	<b>96.9</b>	<b>131.5</b>
Tax	-0.2	-0.3	2.0	-8.9	-19.4	-26.3
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
<b>Attributable Profit</b>	<b>-7.9</b>	<b>-6.5</b>	<b>-9.1</b>	<b>35.5</b>	<b>77.5</b>	<b>105.2</b>
Net Debt (Cash)	-2.2	-15.7	-26.1	-34.7	-67.9	-130.8
Shareholders' Funds	45.0	64.2	96.6	132.0	209.5	314.7
Enterprise Value	260.4	246.9	236.5	227.9	194.7	131.8
<i>Weighted Av Shares (basic)</i>	207.5	255.7	355.6	413.5	413.5	413.5
<i>Weighted Av Shares (fully dil.)</i>	207.5	255.7	365.6	423.5	423.5	423.5
<i>Year end Shares</i>	207.5	255.7	355.6	413.5	413.5	413.5
<b>Per share Analysis (c)</b>						
FRS3 EPS	-3.8	-2.5	-2.5	8.6	18.7	25.4
FD EPS	-3.8	-2.5	-2.5	8.4	18.3	24.8
<b>Adjusted EPS</b>	<b>-3.8</b>	<b>-1.9</b>	<b>-2.2</b>	<b>8.4</b>	<b>18.3</b>	<b>24.8</b>
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	-1.7	-1.0	-2.4	13.2	25.5	34.6
Free Cashflow	-11.0	-4.9	-9.3	2.1	8.0	15.2
NAV	21.7	25.1	27.2	31.9	50.7	76.1
<b>Profitability</b>						
EBITDA Margin	n/m	n/m	-18.1%	34.1%	36.2%	36.6%
EBIT Margin	n/m	n/m	-79.9%	27.9%	31.8%	32.6%
Effective Tax Rate	-2.7%	-5.2%	17.9%	20.0%	20.0%	20.0%
<b>Momentum</b>						
Sales	n/m	n/m	n/m	1032.5%	92.8%	31.3%
EBITDA	n/m	n/m	n/m	-2233.4%	104.3%	32.9%
Adjusted EPS	n/m	n/m	n/m	n/m	118.5%	35.8%
DPS	n/a	n/a	n/a	n/a	n/a	n/a
<b>Financing</b>						
Debt/Equity (%)	-5.1%	-32.4%	-37.1%	-35.6%	-48.0%	-71.1%
Interest Cover (x)	61.0	29.7	-15.5	-43.7	-50.2	-33.2
<b>Valuation (x) £1 66</b>						
<b>P/E</b>	<b>-26.9</b>	<b>-53.4</b>	<b>-47.5</b>	<b>12.3</b>	<b>5.6</b>	<b>4.1</b>
P/OpCF	-61.2	-107.0	-43.1	7.8	4.0	3.0
<b>Dividend Yield (%)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
EV/Sales	n/m	484.3	17.3	1.5	0.7	0.3
<b>EV/EBITDA</b>	<b>-33.2</b>	<b>-54.4</b>	<b>-95.8</b>	<b>4.3</b>	<b>1.8</b>	<b>0.9</b>
EV/EBIT	-33.2	-39.2	-21.7	5.3	2.1	1.0
P/Book	4.7	4.1	3.8	3.2	2.0	1.3

## PetroNeft

### Balance Sheet (\$m)

As at	Dec-08	Dec-09	Dec-10f	Dec-11f	Dec-12f	Dec-13f
Tangible Assets	25.6	28.9	52.3	80.9	122.2	165.8
Intangible Assets	18.7	18.2	15.8	15.8	16.6	15.4
<i>Goodwill</i>	0	0	0	0	0	0
Financial Assets	0	0	0	0	0	0
<b>Fixed Assets</b>	<b>44.5</b>	<b>47.3</b>	<b>68.2</b>	<b>96.8</b>	<b>139.0</b>	<b>181.4</b>
Debtors	3.1	4.9	0.8	10.6	24.5	32.1
Stock	0.0	0.0	4.2	4.2	4.2	4.2
Creditors	-3.9	-2.7	-1.1	-12.7	-24.5	-32.1
<b>Non-Cash Working Capital:</b>	<b>-0.8</b>	<b>2.2</b>	<b>3.8</b>	<b>2.1</b>	<b>4.2</b>	<b>4.2</b>
Other Liabilities	0.8	1.1	1.6	1.6	1.6	1.6
Net Debt	-2.2	-15.7	-26.1	-34.7	-67.9	-130.8
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
<b>Shareholders' Funds</b>	<b>45.0</b>	<b>64.2</b>	<b>96.6</b>	<b>132.0</b>	<b>209.5</b>	<b>314.7</b>
<b>Total</b>	<b>43.7</b>	<b>49.6</b>	<b>72.0</b>	<b>98.9</b>	<b>143.2</b>	<b>185.6</b>

### Cashflow Statement (\$m)

Year End	Dec-08	Dec-09	Dec-10f	Dec-11f	Dec-12f	Dec-13f
Operating Profit	-7.8	-4.8	-9.7	43.1	94.7	127.2
DD&A	0.2	0.2	7.4	9.6	12.9	15.8
Chg in Working Capital	3.4	1.6	-7.5	1.7	-2.1	0.0
Other	0.7	0.5	2.2	0.0	0.0	0.0
<b>Operating Cashflow</b>	<b>-3.5</b>	<b>-2.5</b>	<b>-7.7</b>	<b>54.4</b>	<b>105.5</b>	<b>143.0</b>
Net Interest Payable	0.1	0.2	-0.1	1.2	2.1	4.3
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	2.0	-8.9	-19.4	-26.3
Net Capex	-22.8	-10.3	-26.6	-38.2	-55.0	-58.2
Other	3.3	0.0	0.0	0.0	0.0	0.0
<b>Free Cashflow</b>	<b>-22.8</b>	<b>-12.6</b>	<b>-32.4</b>	<b>8.6</b>	<b>33.2</b>	<b>62.8</b>
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	17.5	25.9	42.8	0.0	0.0	0.0
Currency Translation	0.0	0.0	0.0	0.0	0.0	0.0
Other	-0.8	0.3	0.0	0.0	0.0	0.0
<b>(Inc)/Dec in Net Debt</b>	<b>-6.1</b>	<b>13.6</b>	<b>10.4</b>	<b>8.6</b>	<b>33.2</b>	<b>62.8</b>

## Petronet - Schedule of Exploration Activity

Licence	Well	Target 2P Reserves (mmbbls-net to PTR)	Timing (all 2011)
61	Kondrashevskoye No. 2	12	Spud late Q1, result early/mid Q2
61	North Varyakhs kaya No. 1	6	Spud early/mid Q2, result late Q2
61	Sibkrayevskaya No. 373	44	Spud late Q2, result early Q3
67	Cheremshanskaya No. 3	30	Spud mid Q3, result late Q3/early Q4
67	Ledovaya No.11 (to prove Lower Cretaceous reserves)	15	Spud early Q4, result Q4

Source: Petronet

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