Oil and gas alternatives
Russia

Company update
Equity Research

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Renaissance Capital

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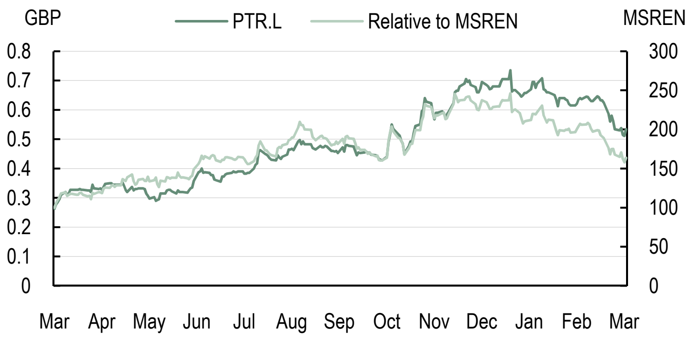
PetroNeft Resources
Long-term growth potential

- **Valuation update.** We have updated our financial model for PetroNeft to take into account recent operational developments, and we have come up with a **new TP of GBp74/share** and a **BUY** rating (previously Under Review). PetroNeft's share price has declined by 24% since the start of the year, and by 27% since its peak on 4 January 2011, while the oil price has increased by 31% and 33%, respectively, over the corresponding period. We find this underperformance unwarranted, as failure to reach its original production target of 4 kbpd is temporary, in our view. Just six months into commercial production and with just 11 drilled wells, any issues with just a couple of wells can distort the company's initial results. However, in our view, this does not provide sufficient reason to question PetroNeft's ultimate reserves potential, as the company's long-term fundamentals remain intact.
- **Clear development strategy.** We think the company should be able to learn the required lessons from the drilling and fracturing operations it has undertaken over the past few months at Pad 1, to achieve stronger results at Pad 2 and 3. Specifically, we expect the company to be more efficient in the drilling and completion process as well as in fracturing to achieve the best results. In addition, PetroNeft has a material exploration programme in 2011 targeting about 120mn bbls of reserves in Licence 61 and 67.
- **An attractive way to play forthcoming tax changes.** In our view, there is a high chance that, following the approval of reduced mineral extraction tax (MET) for small fields at the first reading of the Russian parliament (Duma) on 5 April, the reduced MET will come into effect from 2012, at the latest. PetroNeft stands to benefit the most from this measure among the listed E&P companies, in our view. Additionally, the likely 60/66 regime could boost the company's valuation by about 19%, on our estimates. Combined, we estimate both tax changes would increase our TP by 28% to GBp94.5, implying more than 78% upside potential to PetroNeft's current share price. We therefore view PetroNeft as providing one of the best ways for investors to play the forthcoming oil tax changes in Russia.

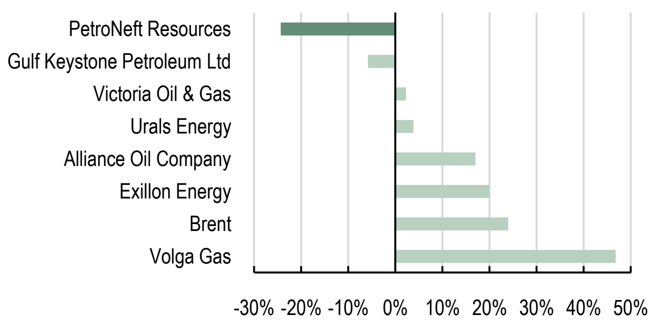
Report date:	13 April 2011
Rating common/pref.	BUY/na
Target price (comm), GBp	74
Target price (pref), GBp	na
Current price (comm), GBp	53
Current price (pref), GBp	na
MktCap, $mn	359.5
EV, $mn	339.1
Reuters	PTR.L
Bloomberg	PTR LN Equity
ADRs/GDRs since	na
ADRs/GDRs per common share	na
Common shares outstanding, mn	416.1
Change from 52-week high:	-27.4%
Date of 52-week high:	04/01/2011
Change from 52-week low:	111.4%
Date of 52-week low:	19/03/2010
Web:	www.PetroNeft.com
Free float in $mn	313
Major shareholder with shareholding	JP Morgan AM (8%), Directors (7.25%)
Average daily traded volume in $mn	2.1
Share price performance over the last 1 month	-16.11%
3 months	-24.29%
12 months	107.28%

Figure 1: Price performance – 52-weeks



Source: Bloomberg

Figure 2: Sector stock performance – three months



Source: Bloomberg

Investment summary

We have updated our financial model for PetroNeft to take into account recent operational developments at the company and we have come up with a new TP of GBp74/share and a **BUY** rating (previously Under Review). PetroNeft's share price has declined by 24% since the start of the year and by 27% since its peak on 4 January 2011, while the oil price has increased by 31% and 33%, respectively, over the corresponding period. The FTSE E&P Index has gained 6% and 3%, respectively, over the same period.

The main reason for this underperformance by PetroNeft, in our view, is slower development at the Lineyonye field (Licence 61). The company failed to meet its original production guidance of 4 kbpd by YE10, instead producing only 2.75 kbpd. It has also been slow in putting those wells back into production after fraccing operations which were undertaken during 1Q11.

In our view, these failures are temporary, and are unlikely to be an indication of fundamental problems at the company but instead we find the current valuation attractive given the long-term growth potential of the company, its vast resource base and its skilful and dedicated management team.

We see three key factors that provide upside potential to PetroNeft's valuation in the next six-to-nine months.

- **Tax changes.** We expect two main tax changes in the near term. The first is the introduction of a reduced MET rate for small fields (expected to become effective from 2012 at the latest) and a lower coefficient for export duty on crude oil (60% instead of 65%). The reduced MET rate will, we estimate, increase our TP by 9% to GBp80.5/share, while the lower export duty could boost our valuation by 19% to GBp87.8/share. If both measures are introduced, all else remaining equal, we will likely raise our TP by 28% in total to GBp94.5/share.

- **Exploration results.** PetroNeft has a large resource base of 519mn bbls of possible reserves and 99 mn bbls prospective resources of which about 120mn bbls will be targeted in 2011 by drilling three wells at L61 and two wells at L67. We expect the first exploration results to be known in June 2011.

- **Development results.** This is ultimately going to be the most important factor for PetroNeft's future success, however, we do not expect any material newsflow until September 2011 when new production results post-fraccing of up to eight new wells are expected to be announced. We think that the company can apply the 'lessons learnt' following its winter fracturing campaign towards fracturing new wells in summer and will announce stronger operational results in 2H11.

It is also worth mentioning that PetroNeft could further boost its resource base by participating in licence auctions in the Tomsk Region or through other non-organic growth options. However, we expect management to focus more on current operations as this looks to be the number-one priority for the company at the moment.

Valuation

We have valued PetroNeft's equity using a NAV approach for which we break down the company's assets into producing (or close to production) and exploration assets (see Figure 3).

Figure 3: NAV of PetroNeft

Asset	Type of reserves/ resources	Amount, mn bbls	Valuation method	Value ($mn)	Implied value per barrel, $/boe
L61	2P	82.9	DCF	210.3	2.5
	Risked resources (including 3P)	278.7	Comparables	195.1	0.7
Total L61		**361.6**		**405.4**	**1.1**
L67	2P	14.0	DCF	27.0	1.9
	Risked resources (including 3P)	68.0	Comparables	47.6	0.7
Total L67		**82.0**		**74.6**	**0.9**
Total L61+L67		**443.7**		**480.0**	1.1
Add net cash (FY10E)				20.4	
Equity value				**500.4**	
Shares outstanding, mn				416.1	
Per share, $				1.2	
Per share, GBp				**73.8**	
Current price, GBp				53	
Upside/(downside)				39%	

Source: Company data, Renaissance Capital estimates

We have separately valued 2P reserves at each licence using a DCF valuation methodology based on Ryder Scott's projections, the company's estimates and our own adjustments, particularly with regard to oil prices and the discount rate. We used a long-term oil price assumption of $80/bbl and a WACC of 12%, which we think is relevant for the company's risk profile.

As a cross-check, we compared the implied per-barrel reserves valuations with CIS E&P peer companies which quite neatly confirmed our DCF valuation results (see Figure 4). Russian E&P companies with a high share of proven reserves are the cheapest among all CIS peers and currently trade at about $2.9/boe of 2P reserves, which is a function of the heavier taxation regime in Russia. The Russian universe is quite diverse with companies trading in a range of $0.9/boe to $4.1/boe EV/2P reserves. In our view, the lower end of the valuation range is less relevant as Urals Energy has recently undergone a heavy asset/debt restructuring programme and is largely seen by investors as a distressed asset; while over half of Volga Gas's 2P reserves are represented by gas, which generates lower returns compared with crude, due to the lower domestic prices on gas. Excluding these two companies from the universe will lead to a higher multiple of $4.0/boe.

This adds confidence to our DCF valuation and implies additional upside potential if comparable valuation methodologies were used. However, we note that since PetroNeft is at an early stage of production it may trade at a discount to those peers with a longer production history. We also find it reasonable that, having failed to meet its original production target of 4 kbpd before FY10, investors may be willing to assign a lower multiple to PetroNeft's 2P reserves. Having said all this, we acknowledge that our estimates may ultimately prove too conservative compared with the actual performance of PetroNeft in the future. This creates an opportunity for additional upside potential to our valuation.

Figure 4: Comparable valuation of CIS E&P companies

	Share price as of 6 Apr 2011, Local currency	Shares outstanding, mn	Mkt Cap, $mn	FY10 net debt, $mn	EV, $mn	2P, mnbbls	2P + risked resources, mnbbls	EV/2P	EV/Total resources
Producing E&P companies									
Volga Gas	125	81.0	165	-27	138	76	202	1.83	0.69
PetroNeft	53	416.1	359	-20	339	97	444	3.50	0.76
Exillon Energy	457	138.1	1,028	-8	1,019	239	439	4.27	2.32
Urals Energy	13.6	245.2	54	-2	52	59	84	0.89	0.62
Alliance Oil	122	171.5	3,333	811	2,644	638	979	4.14	2.70
Russian average								**2.92**	**1.42**
Zhaikmunai	12.5	185.0	2,313	264	2,577	527	1,086	4.89	2.37
Dragon Oil	600	515.6	5,039	-1,337	3,702	899	1,127	4.12	3.29
Central Asian average								**4.51**	**2.83**
Regal Petroleum	49	318.4	254	-28	226	151	284	1.50	0.80
JKX	325	171.6	909	-107	802	89	181	9.04	4.44
Ukrainian Average								**5.27**	**2.62**
Exploration peers									
Petrogrand	10.3	40.3	66	-85	-19	0	65	n/a	n/a
Matra Petroleum	3.1	1,114.9	56	-3	53	15	27	3.49	1.97
Russian average								**3.49**	**1.97**
Cadogan	49	231.1	186	-43	142	3	497	54.89	0.29
Shelton Petroleum	0.4	532.0	34	-1	33	9	83	3.63	0.39
Ukrainian Average								**29.26**	**0.34**
Jupiter Energy	0.06	1511.4	91	-9	82	24	113	3.40	0.73
Max Petroleum	16.8	918.1	251	56	307	6	1,120	51.14	0.27
Roxi	4.63	465.1	35	49	84	8	104	11.16	0.81
Tethys	1.46	260.6	397	-71	326	14	370	23.27	0.88
Petro Matad	185	183.3	553	-9	544		323		1.68
Central Asian average								**22.24**	**0.87**

Note: Alliance Oil EV adjusted for value of Khabarovsk refinery (c $1.5bn)

Source: Bloomberg, Company data, Renaissance Capital estimates

It is also worth pointing out that, in our view, according to estimates by an independent petroleum consultancy, Ryder Scott, the value of 2P reserves (applying a 12% discount rate) for L61 is $319.8mn ($3.9/boe implied per-barrel valuation), while it valued L67 (50% stake) at $32.9mn ($2.3/boe). Ryder Scott used an $80/bbl long-term oil price, which is in line with our long-term price assumption. Our valuation is therefore about a one-third below Ryder Scott's appraisal, which we attribute primarily to the inflation factor (we have adjusted our costs for inflation, leaving the long-term oil price flat, while Ryder Scott used real terms and assumed an $80/bbl long-term price in real terms).

For the valuation of exploration upside potential, we have applied a $0.7/boe multiple which we derived from the average trading multiple for Central Asian companies focused on exploration and applied around a 20% discount. We have also adjusted the resources base of PetroNeft for risk factors (similar to its listed peers) although we note that the exploration risks of PetroNeft could very well prove to be much lower, due to a significant amount of exploration work already having been undertaken during Soviet times, better known and generally less complex geology compared to some of its Central Asian peers (some of them are targeting sub-salt prospects at the depth below 5,000 metres), as well as strong and knowledgeable local geological team.

With significant variance within the E&P universe we decided to take a closer look at PetroNeft's closest peer in Russia, Exillon Energy. Since we do not cover the latter, we used either public data provided by the company (for reserves for example) or consensus estimates (for financial forecasts). The result of the side-by-side analysis is shown below.

Figure 5: Side-by-side comparison of PetroNeft vs Exillon Energy

	PetroNeft	Exillon Energy
YtD	-24%	40%
6m	18%	121%
12m	63%	126%
Current price, GBp	53	457
GBP/$ rate	1.63	1.63
Shares outstanding	416.1	138.1
Mktcap, $mn	359.5	**1,027.8**
FY10 Net debt, $mn	-20.4	-8.4
EV	339.1	**1,019.5**
2P reserves	96.9	239
3P reserves	615.8	439.0
Production, bpd		
YE10	2,750	8,100
2011	4,117	14,000
2012	7,236	25,000
Peak production	32,083	45,000
Revenues, $mn		
2010	7	85
2011E	71	307
2012E	144	548
EBITDA, $mn		
2010	neg	4
2011E	20	66
2012E	36	140
EBITDA margin, %		
2010	neg	5%
2011E	28%	22%
2012E	25%	26%
EV/2P	3.5	4.3
EV/3P	0.6	2.3
EV/Peak output ($/boe)	29.0	62.1
EV/EBITDA		
2011E	17.3	15.4
2012E	9.3	7.3
2013E	5.3	n/a

Source: Company data, Bloomberg, Renaissance Capital

PetroNeft's EV is three times less than that of Exillon Energy, yet both companies have similar 3P reserves. We attribute this to higher share of 2P reserves in Exillon Energy's case, the higher current production rate at Exillon Energy, as well as the potentially higher quality of reservoirs at Exillon Energy, which could potentially allow the company to extract more value from its reserves. Nevertheless, we tend to think that the market may be too conservatively estimating PetroNeft's potential (or rather may have too high expectations for its peer). We also note that on a 2013E EV/EBITDA multiple PetroNeft will be trading at 5.3x, while its production could still grow almost 2.5x before 2015 from its 2013 level (from 13 kbpd to 32 kbpd in 2015).

We have also analysed PetroNeft's equity valuation sensitivity to changes in oil prices and WACC. The results signal that PetroNeft's valuation is fairly resilient to falling oil prices (Figure 6).

Figure 6: TP sensitivity to WACC and crude price changes, GBp/share

		Oil price ($/bbl)								
		60	70	80	90	100	110	120	150	200
WACC	10.0%	67.9	73.8	79.8	85.7	91.6	97.5	103.5	121.2	150.8
	11.0%	65.5	71.1	76.6	82.2	87.7	93.3	98.9	115.5	143.2
	12.0%	63.3	68.6	73.8	79.0	84.2	89.4	94.6	110.3	136.3
	13.0%	61.3	66.3	71.2	76.1	81.0	85.9	90.8	105.5	130.0
	14.0%	59.5	64.1	68.8	73.4	78.0	82.6	87.2	101.1	124.1
	15.0%	57.9	62.2	66.6	70.9	75.3	79.6	84.0	97.0	118.8
	16.0%	56.3	60.4	64.6	68.7	72.8	76.9	81.0	93.3	113.8

Source: Renaissance Capital estimates

Figure 7: Upside/(downside) potential to current share price

		Oil price ($/bbl)								
		60	70	80	90	100	110	120	150	200
WACC	10.0%	28%	39%	51%	62%	73%	84%	95%	129%	184%
	11.0%	24%	34%	45%	55%	66%	76%	87%	118%	170%
	12.0%	19%	29%	39%	49%	59%	69%	79%	108%	157%
	13.0%	16%	25%	34%	44%	53%	62%	71%	99%	145%
	14.0%	12%	21%	30%	38%	47%	56%	65%	91%	134%
	15.0%	9%	17%	26%	34%	42%	50%	58%	83%	124%
	16.0%	6%	14%	22%	30%	37%	45%	53%	76%	115%

Source: Renaissance Capital estimates

According to our estimates, the fair value of PetroNeft's shares will fall below its current valuation at an oil price below $60/bbl, or in the event of rapidly rising interest rates.

Finally, we have not incorporated any tax changes such as a reduced rate for MET or a 60% export duty instead of the current 65% rate. Both changes have yet to be approved and to come into force. The first measure is likely to become effective shortly (from 2012 at the latest, in our view), as the Russian parliament (Duma) approved a reduced MET rate for small fields at its first reading on 5 April. Under the new law, a 50% discount to MET will apply to fields with less than 1mnt of initial reserves, while the discount for fields with less than 3mnt of reserves will be 25% and will gradually diminish as reserves approach 5mnt. According to MinFin, the new initiative could lead to an additional 10.2mnt of production in the first year and up to 214mnt during the next 10 years, coming from 134 small fields. For PetroNeft, this may become relevant from 2012, when the company plans to launch the Arbuzovskoye field, and later in 2013, with the launch of the Tungolskoye and Ledovoye fields. According to our estimates, PetroNeft's per-barrel profitability could rise by about 25% as a result of such measures.

The 60/66 regime is aimed at reducing the tax subsidy for the downstream segment and easing taxation for the upstream segment. According to government estimates, the overall tax proceeds from the oil sector is not expected to change as a result, however, the new regime will change the distribution of the tax burden between downstream and upstream, favouring the former. We summarise the potential changes to our TP under these two possible scenarios in the table below.

Figure 8: NAV of PetroNeft under base case, reduced MET case and 60/66 regime

Asset	Type of reserves/ resources	Amount, mn bbls	Valuation method	Value ($mn)	Implied value per barrel, $/boe	Reduced MET	% change	Implied value per barrel, $/boe	60/66 regime	% change	Implied value per barrel, $/boe
L61	2P	82.9	DCF	210.3	2.5	262.1		3.2	291.9		3.5
	Risked resources (including 3P)	278.7	Comparables	195.1	0.7	195.1		0.7	195.1		0.7
Total L61		361.6		**405.4**	**1.1**	**457.2**	13%	**1.3**	**487.0**	20%	**1.3**
L67	2P	14.0	DCF	27.0	1.9	36.3		2.6	40.3		2.9
	Risked resources (including 3P)	68.0	Comparables	47.6	0.7	47.6		0.7	47.6		0.7
Total L67		82.0		**74.6**	**0.9**	**83.9**	13%	**1.0**	**87.9**	18%	**1.1**
Total L61+L67		443.7		**480.0**	1.1	**541.2**	13%	1.2	**574.9**	20%	1.3
Add net cash (FY10E)				20.4		20.4			20.4		
Equity value				**500.4**		**546.3**			**595.3**		
Shares outstanding, mn				416.1							
Per share, $				1.2							
Per share, GBp				**73.8**		**80.5**			**87.8**		
Current price				53		53			53		
Upside/(downside)				39%		52%			66%		

Source: Renaissance Capital estimates

Our base-case valuation implies about 39% upside potential to PetroNeft's share price; however, we estimate our valuation will increase by 9% if reduced MET for smaller fields becomes effective, and increase by a further 19% if the 60/66 regime is introduced. Both measures combined could lead to around a 28% boost to our valuation, and we estimate our revised TP under this scenario would imply about 78% upside potential.

Current status of operations

Licence 61

Development status

Last year, PetroNeft targeted 4 kbpd production by YE10. However, actual production reached only 2.75 kbpd which can be explained by two factors. First, there were only nine wells producing instead of 11 as originally planned. Wells No. 1 and No. 6 were not put into operation. In the Lineynoye No. 1 well, which was drilled in 1972, the diameter of the well casing was too small to accommodate an electrical submersible pump (ESP), and a special-order screw pump was purchased for this well. According to PetroNeft, the company is in the process of installing the necessary pump. The well produced around 275 bopd on natural flow during pilot production in 2009, but production from the well to date has been minimal because it could not flow naturally against the back pressure of the process system caused by the ESPs in the other wells. The company expects that the screw pump should remedy this issue. Repair of a casing hole in the Lineynoye No.6 well has just been completed and an ESP is currently being re-installed. This well had previously produced around 200 bopd.

Second, as a result of greater-than-expected formation damage, caused by the drilling and completion process, the initial pre-fracture stimulation flow rates were not as high as expected in some of the wells. The company undertook hydraulic fracturing of nine wells (which had been planned regardless of drilling results) starting from early January 2011. In PetroNeft's new guidance the target production rate is at the end of the first quarter thereby allowing all of the new wells to be fracture stimulated and returned to production.

As of early April, hydraulic fracturing was completed and all nine wells have been put back into operation, achieving production of about 3 kbpd. The average flow rate per well in operation amounts to about 333 bpd. As we understand, the flow rates at individual wells vary considerably. According to management, various amounts of proppant have been used during fracturing, and in four wells in particular, the company believes that a larger frac (i.e. greater tonnage of proppant) would have produced a better rate. The company seems to have taken this into account and plans to apply the 'lessons learnt' during the fracturing of new wells in summer 2011. There are two more wells (No. 1 and No. 6) that are currently offline and are expected to be back on line by early-May 2011.

In 2011 PetroNeft plans on drilling nine wells at Pad 2 (approximately 1.5 km to the north of Pad 1) and eight wells at Pad 3 (approximately 3 km to the west of Pad 1) with a total of 17 development wells. The first two wells at Pad 2 have already been drilled and cased, with net oil pay of 18.1 metres and 8.2 metres. The rig for Pad 3 and all the materials have been mobilised to site, and the company is in the process of spudding the first well.

The company's plans are to fracture up to eight of those 17 new development wells during summer using a heli-frac crew. PetroNeft has already purchased the necessary proppant and frac tubing, and moved these items to the field by winter road. In addition, a new workover rig has been acquired, which will be staffed with its own crew. The company hopes that this will speed up workovers and increase their quality.

Works to tie-in Pads 2 and 3 to the existing central processing facility are ongoing and it is expected that this work will be completed by May 2011, thereby allowing new wells to be brought swiftly into production. All of the major equipment and materials necessary to expand the central processing facility from 7,400 bpd to 14,800 bpd have been delivered to the site and this work is proceeding on schedule and is expected to be completed by July 2011.

While the recent operational results appeared to be below original production targets, we do not think this is an indication of major issues with the quality of reserves or management's expertise. Since PetroNeft is only six months into commercial production, and with only 11 drilled wells, any issues with only a couple of its wells can distort its initial results. However, in our view, this does not provide sufficient reason to question the ultimate reserves potential as the company's long-term fundamentals remain intact.

We have benchmarked the performance of key peers in the region to put PetroNeft's future performance into context (see Figure 9).

Figure 9: Analysis of peers in Tomsk Region

Company	Annual production, kbpd				Total growth (x times)	CAGR	2P reserves, mn bbls	2P Reserves life, years	Avg flow rate per well, bpd
	2007	2008	2009	2010					
Imperial Energy	2.3	5.6	9.1	15.1	6.6	88%	782	142	199
STS-Service	0.5	2.1	2.0	2.6	5.6	78%	44	45	139
MOL	0.8	1.4	2.0	3.0	4.0	58%	32	30	142

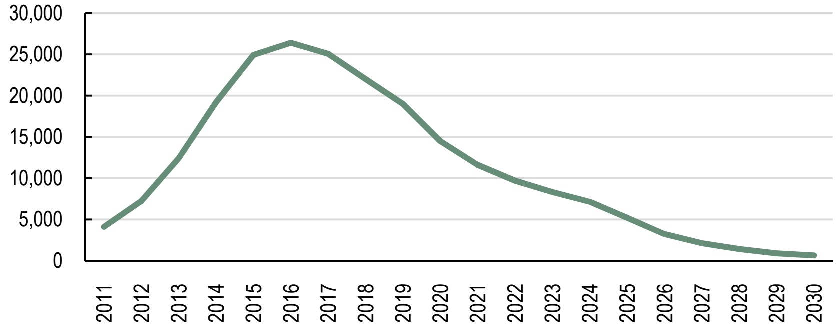
Note: 2P reserves for MOL are estimated based on Russian classification as C1+10% of C3

Source: company data, Interfax, Renaissance Capital

We should note though that none of the peers listed above can be directly compared with PetroNeft's Licence 61. MOL's operating subsidiary, Matyshkinskaya Vertikal, operates a licence block to the north of L67, so it is less comparable to licence 61 of PetroNeft. Imperial Energy has a number of licences in the Tomsk Region on both sides of the Ob River. To the best of our knowledge, Kiev Eganskoye (the closest field to the L61 licence area) accounts for a much lower share of total output of Imperial Energy, with the majority of production coming from the western licences (not comparable to L61). STS-Service, a subsidiary of Gazprom Neft, owns assets in the north and north-western part of the Tomsk Region and its operations are also not directly comparable to L61. We have to admit that the north-eastern area of the Tomsk Region has a relatively short development record, therefore future production projections are subject to a wider range of possible outcomes. Nevertheless, it is important to note that we used original flow rates at Pad 1 of PetroNeft, which were, on average, higher compared with the three peers above and stood at more than 300 bopd. We have assumed 150-180 bopd flow rates for new wells at Pad 2 and 3 reflect the expected worsening of the reservoir qualities in new pads.

In early April, PetroNeft slightly downgraded its production target to 7-8 kbpd (vs 8 kbpd originally) and moved the deadline for achieving this by three months to end-1Q12, after all of the wells have been fractured. We find this decision prudent since now the company has some flexibility in deciding on the schedule and pace of fracturing operations for new wells, which will be the most important factor for achieving the revised target. Using Ryder Scott's estimates, we forecast that the company should be on track to produce, on average, about 4 kbpd in 2011 with over 7 kbpd production in 1Q12 and about 7.2 kbpd production in 2012, rising to 12.4 kbpd in 2013 (see Figure 10).

Figure 10: Licence 61 production profile, kbpd



Source: Ryder Scott, Renaissance Capital estimates

Exploration status

PetroNeft's exploration programme targets over 60mn bbls of new reserves across three prospects in L61 during 2011. The first of these, the Kondrashevskoye No. 2 well, should spud in late-April; site preparation is complete, the rig has been mobilised to location and rig-up is under way. The second well in the schedule at Sibkrayevskaya No. 372 will target the largest prospect in the programme at over 40mn bbls. At present, site preparation and mobilisation of the rig and materials is complete and rig-up operations are planned to start in late-April for a June spud. The site for the North Varyakhskaya No. 1 well has also been prepared and the rig and materials are being moved to the site. This well will be the last exploration well drilled at Licence 61 in 2011, with a planned spud in July.

The company's prospects inventory is quite impressive post-2011, with over 20 additional prospects and four leads containing about 350mn bbls of possible reserves and 74.5mn bbls of unrisked potential resources, according to Ryder Scott.

Licence 67

Exploration status

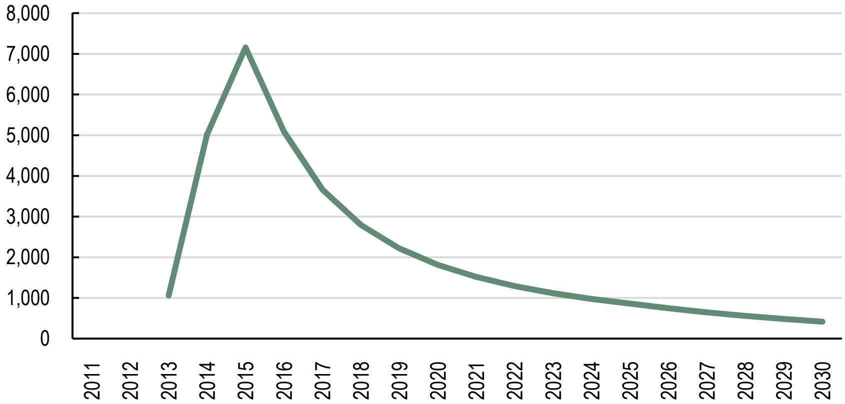
Having acquired Licence 67 at public auction in December 2009, PetroNeft contracted TomskGeophysicalCompany (TGK) to consolidate, reprocess and re-evaluate 4,432 km of CDP 2D seismic data acquired in and adjacent to the license area between 1969 and 2001. TGK also digitised and reinterpreted 21 vintage wells located in and adjacent to the licence area and tied these wells into their integrated interpretation of the licence area. This comprehensive evaluation started in February 2010 and was completed in December 2010. Based on the results of the study, L67 2P reserves are estimated at 14.0mn bbls (net to PetroNeft) at Ledovoye oil field, while its possible reserves at Ledovoye field and the Cheremshanskaya structure amount to 85.1mn bbls

PetroNeft plans to commence the acquisition of the 750 km of seismic data and drill two exploration wells in 2011. The two wells will be drilled on the Ledovy oil field and Cheremshanskaya Structure, targeting potential bypassed pay indentified in the

TGK study. Currently, the company is in the process of selecting a drilling contractor for its two exploration wells to be drilled in 2011. The exploration programme at L67 for 2011, targets over 60mn bbls. The two wells, Cheremshanskaya No. 3 and Ledovoye No. 2a, are located close to existing all-weather roads and will be drilled in 2H11 following the Licence 61 exploration wells. Mobilisation of equipment for the construction of the Cheremshanskaya site has already commenced.

We expect that first production from Ledovoye field could start as early as 2013 at about 2.1 kbpd average level, rising to 10.0 kbpd in 2014 and peaking at 14.3 kbpd in 2015 (see Figure 11).

Figure 11: Licence 67 production profile, kbpd



Source: Ryder Scott, Renaissance Capital estimates

Background on assets

PetroNeft's licences

PetroNeft is the owner and operator of two licences in the Tomsk Region which, combined, covers an area of 7,438 km2. PetroNeft, through its 100% subsidiary Stimul-T, fully owns and operates the Tungolsky Licence (Licence 61, L61) which covers an area of 4,991.8 km2. The second licence, Ledovy (L67) is 50% owned by PetroNeft, however the company remains its sole operator. The remaining 50% in L67 is owned by Arawak Energy (a company taken over by oil trader, Vitol). Detailed information on the company's reserves and resources in both licence areas is provided in the table below (Figure 12).

Figure 12: PetroNeft's reserves and resources summary

Asset	1P	2P	3P	Risk factor (3P)	3P risk adjusted	Prospective resources	Risk factor	Risked resources	Total reserves and risked resources
Licence 61									
Fields									
Lineynoye	5.2	22.7	28.5		28.5				28.5
West Lineynoye	2.7	23.3	29.2		29.2				29.2
Kondrashevskoye	0.6	8.1	26.1		26.1				26.1
Tungolskoye	1.4	15.5	19.6		19.6				19.6
Arbuzovskoye	2.0	13.2	16.6		16.6				16.6
Total fields	**11.8**	**82.9**	**120.0**		**120.0**				**120.0**
Prospects and Leads									
25 Prospects			410.7	55%	226.4				226.4
4 Leads						74.5	20%	15.3	15.3
Total L61	**11.8**	**82.9**	**530.7**		**346.4**	**74.5**		**15.3**	**361.6**
Licence 67 (50%, net to PTR)									
Ledovoye field (UJ)	1.5	14.0	17.4		17.4				17.4
7 Prospects			67.7	55%	54.6	24.9	40%	10.0	47.2
Total L67	**1.5**	**14.0**	**85.1**		**72.0**	**24.9**		**10.0**	**64.7**
Total PetroNeft	**13.4**	**96.9**	**615.8**		**418.4**	**99.3**		**25.3**	**443.7**

Source: Company data, Renaissance Capital

Licence 61 (L61)

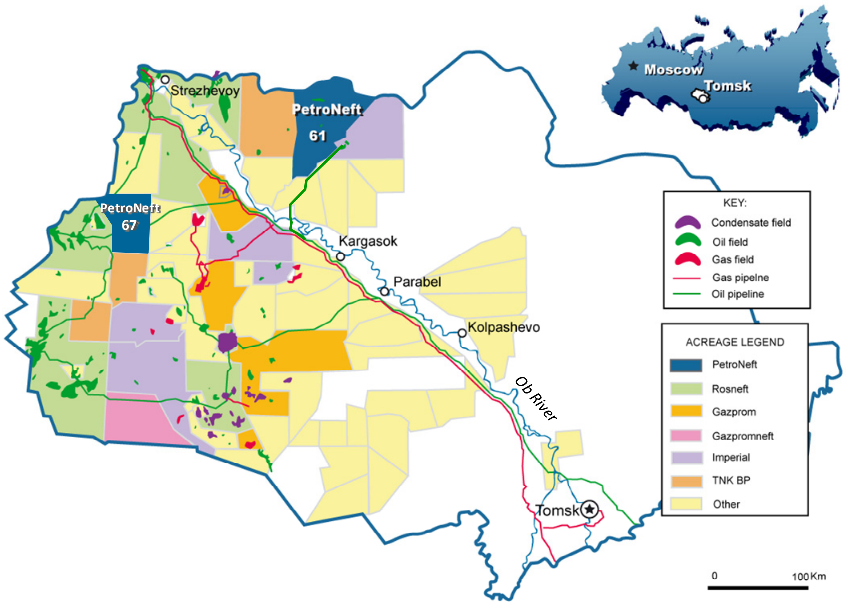
PetroNeft's 100% Russian subsidiary Stimul-T is the sole licence holder of the 4,991.8 km2 Licence area 61 (Tungolsky), located in the Tomsk Region of Russia. As shown in Figure 13, Licence 61 is located in the north-west of the Tomsk Region, in the Alexandrov administrative district, in the prolific West Siberian 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.

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 April 2030.

Ryder Scott, in its most recent report dated 1 January 2011, identified the licence area as holding 82.9mn bbls of remaining proved and probable reserves attributable to the five discovered fields to date. Those fields, according to Ryder Scott, also hold 37.1mn bbls of possible reserves, making their total reserve base equal to 120mn bbls. In addition, the licence area holds 25 prospects with possible reserves of 410.7mn bbls, or 226.4mn bbls if adjusted for risk. There are also four leads with prospective resources of 74.5mn bbls (15.3mn bbls risk-adjusted resources).

Figure 13: Location of PetroNeft's licences



Source: PetroNeft

Geologically, L61 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/Cenezoic cover.

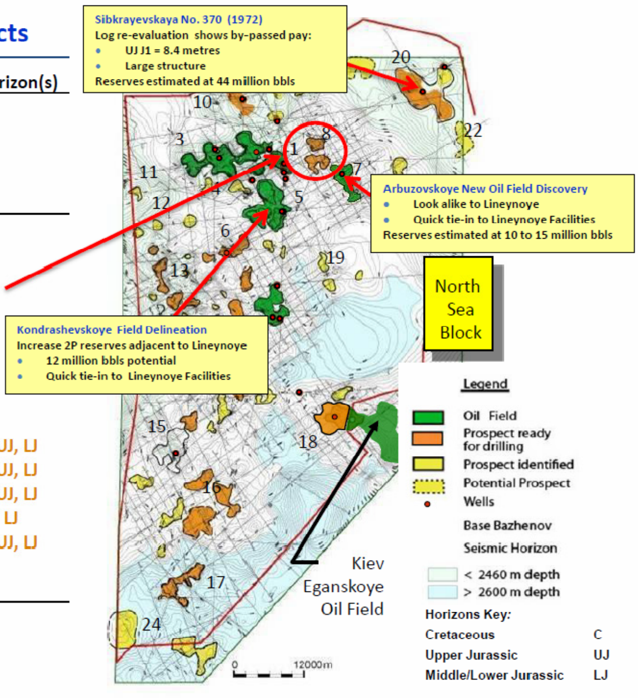
More than 30 Upper Jurassic (UJ) structures have been identified in the licence area. Deep wells have been drilled on nine structures and five oilfields have been discovered in the deposits of the UJ sedimentary cover (the Lineynoye, Tungolskoye, West Lineynoye and Kondrashevskoye [Korchegskaya], Arbuzovskaya oilfields).

In addition, further prospects have been identified in both the UJ and other horizons and have been included in the possible reserves category (see Figure 14).

Figure 14: Licence 61 oil fields, prospects and leads

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
	7	Arbuzovskoye (Varyakhskaya)	UJ
Prospects	2	Tungolskoye West Lobe and North (2)	UJ
	4	Lineynoye Lower	UJ
	6	West Korchegskaya	LJ
	8	Varyakhskaya 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



Source: PetroNeft

The additional prospects identified include the following:

- Twenty-three major structures or groups of structures that are well defined four-way dip structural closures at the UJ Reservoir interval (Base Bazhenov seismic horizon). 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.

- Ten 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 (MJ) seismic horizon. The probability distribution functions of the other volumetric parameters, including net pay, were based on data from a report prepared by *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 Ryder Scott report 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.

Licence 67

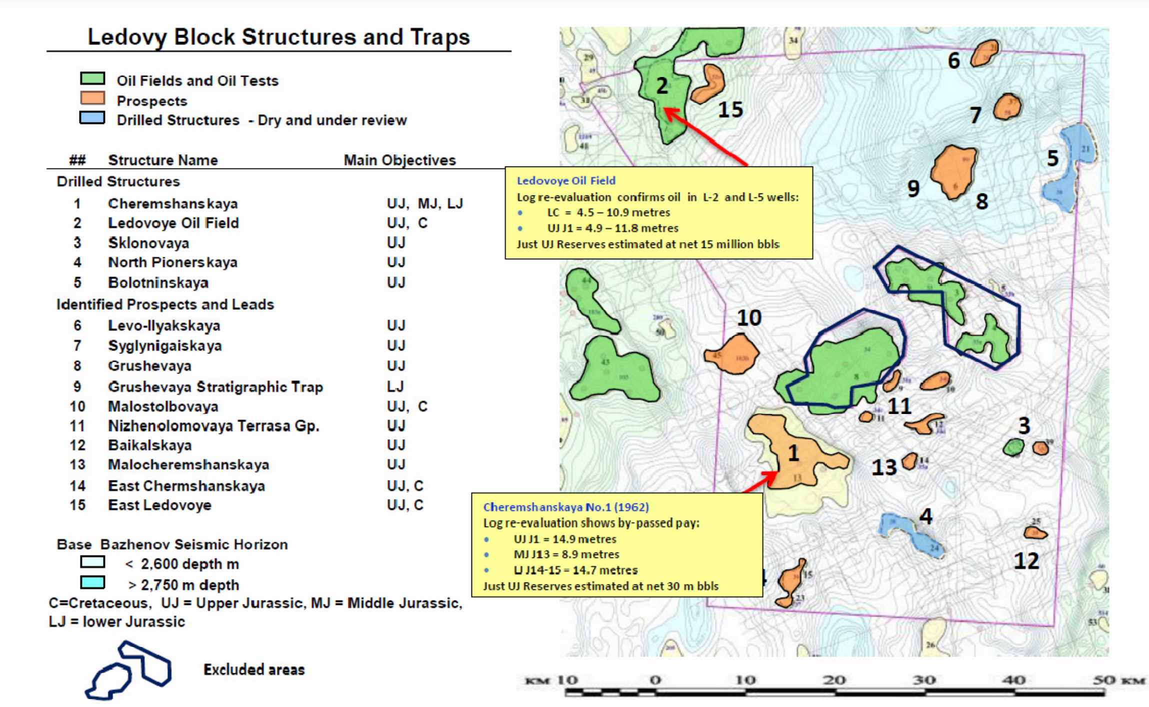
PetroNeft acquired Ledovy Licence (L67) at a state auction in December 2009 for $1.4mn. In January 2010, Arawak Energy exercised its right under the terms of the 2008 Area of Mutual Interest agreement to acquire a 50% interest in Licence 67 with PetroNeft remaining as operator. The previous owner (Tomskneft which is jointly owned by Rosneft and Gazprom Neft) which owned the licence during 1998-2008 did not meet all the licence requirements and the licence was ultimately revoked by the government.

The licence was registered by the Subsoil Agency on 27 January 2010 with a validity term of up to 25 years (until 15 January 2035). The licence terms allow for the geological survey, exploration and production of hydrocarbons at the Ledovy area.

L67 covers an area of 2,447 km2. The block is located to the west of the Ob River (in a more developed and better-explored area) some 570 km north-west of the city of Tomsk. The oil pipeline (Vasugan-Raskino) goes immediately through the centre of the block. There are two oil fields in the territory of the block, Grushevoye and Lomovoye, which were excluded from the licence area as these belong to third parties (Rosneft through Tomskneft and Russneft, respectively). As of 1 January 2008 prospecting drilling was performed in five structures (Ledovaya, Sklonovaya, North-Pionerskaya, Cheremshanskaya and Bolotninskaya [see Figure 15 below]). The first drilling started in 1961 (Cheremshanskaya) with a well reaching 3,062m in depth and tested in 1962. All the wells were later abandoned.

Geologically, L67 is located in the south-eastern part of the West Siberian basin, which itself is made up of several large heterochronous blocks. The licence block is located within the Central West Siberian block, which represents a series of sub-parallel anti-clinorial zones divided by inter-mountain troughs and internal basins. The oil and gas oil bearing potential of the licence territory is primarily tied to the UJ deposits of the J1 interval. Two developed oil fields, Lomovoye and Grushevoye, with J1 as the main productive horizon are located immediately within the borders of the licence block.

Figure 15: Seismic map of Licence 67



Source: PetroNeft

It is important to note that most of the early exploration wells drilled in the 1970s were drilled on structures delineated by single trace analogue seismic data acquired in the 1950s. The modern 2D seismic data was only acquired after the wells were drilled.

During Tomskneft's ownership between 1998 and 2008 there were several exploration wells drilled and 2D seismic data acquired. In 2001 well No.21was drilled and completed with testing on the Sklonovaya Structure; oil influx of 1.2 m3/day was obtained from the J1-1 and J1-2 interval. The North-Pionerskaya Structure was also drilled in 2001 and was abandoned after no-pay zones were found in the section. In 2003 well No.5 was completed on the Bolotninskaya structure. Drilling of these three exploration wells in the License Block showed a low accuracy of structural imaging. As a result Tomskneft acquired 230.4 km of additional CDP-2D seismic data in 2006-2007. Eventually there were specified structural plans on all the main reflecting horizons; the oil reservoir contour in J1-2 was specified on Ledovaya structure; a considerable Paleotectonic trap in J1-3/4 was prepared for drilling on Cheremshanskaya Structure, and on the eastern flank of the structure they mapped significant structural and lithological traps in J1-1, J1-2. Within the North-Pionerskaya structure in J1-3/4 two small structural traps were identified. In the area of the Syglynigaiskaya structure in J1-3/4, J12, J11 a paleotectonic oil trap was identified. No prospects for Lower Cretaceous deposits were identified.

The present day Russian registered resource base of the licence block is represented with reserves of category C3 and D1+D2. Initial recoverable C3 reserves of oil make 7.318mnt (Grushevaya non-anticline trap – 3.7 mnt, Baikalsakaya area – 1.918 mnt, Sklonovaya SLT -1.7 mnt) as of 1 January 2008.

Hydrocarbon resources of D1+D2 are estimated at 4.7mnt as per quantitative estimate by *A.E. Kontorovych* as of 1 January 2002.

In 2010 PetroNeft contracted *TGK* to consolidate, reprocess and re-evaluate 4,432 km of CDP 2D seismic data acquired in and adjacent to the License Area between 1969-2001. TGK also digitised and reinterpreted 21 vintage wells located in, and adjacent to, the licence area and tied these wells into their integrated interpretation of the licence area. This comprehensive evaluation started in February 2010 and was completed in December 2010.

There are 15 identified structures in the licence area, of which five have been drilled and 10 represent prospects and leads, mostly representing UJ aged rocks and some with multiple intervals (Middle Jurassic, Lower Jurassic and Cretaceous). Of those 15 structures, there is one oil field – Ledovoye – with 2P reserves of 14.0mn bbls net to PetroNeft. Ryder Scott analysed only eight UJ prospects and three Lower-to-Middle Jurassic prospects. Based on a reinterpretation of Soviet logging data by TGK in 2010, and according to Ryder Scott's estimates, the biggest oil-bearing potential lies in the Cheremshanskaya structure with possible reserves (100%) of 71.4mn bbls in UJ interval and an additional 22.2mn bbls and 41.8mn bbls of possible reserves in Middle-and-Lower Jurassic prospects. PetroNeft's share of the total possible reserves of the Cheremshanskaya structure is 67.7mn bbls. In addition, Ryder Scott estimated 24.9mn bbl of net prospective resources with a risk factor of 46%, on average. Figure 16 summarises the results of Ryder Scott's estimates.

Figure 16: Possible and exploration resources

Prospect	Best estimate	Risk factor	Risk adjusted
Possible			
Cheremshanskaya			
Upper Jurassic	35.7	90%	33.0
Middle Jurassic	11.1	65%	7.2
Lower Jurassic	20.9	73%	15.3
Total Cheremshanskaya	**67.7**	**81%**	**55.5**
Exploration resources			
Levo-Ilyakskaya, UJ	1.0	46%	0.5
Syglynigaiskaya, UJ	1.8	46%	0.8
North Grushevaya, UJ	6.8	46%	3.1
North Grushevaya, LJ-MJ	5.3	24%	1.3
Malostolbovaya, UJ	4.6	43%	2.0
Nizhenolomovaya, UJ	2.0	40%	0.8
East Cheremshanskaya, UJ	1.9	46%	0.9
East Ledovoye	1.4	46%	0.7
Total exploration resources	**24.9**	**40%**	**10.0**

Source: Ryder Scott, Renaissance Capital estimates

The general UJ reservoir properties for the Ledovy oil field and untested Cheremshanskaya structure, which are based on the reinterpretation of the well log data by *TGK* are summarised in the following table.

Figure 17: General reservoir properties

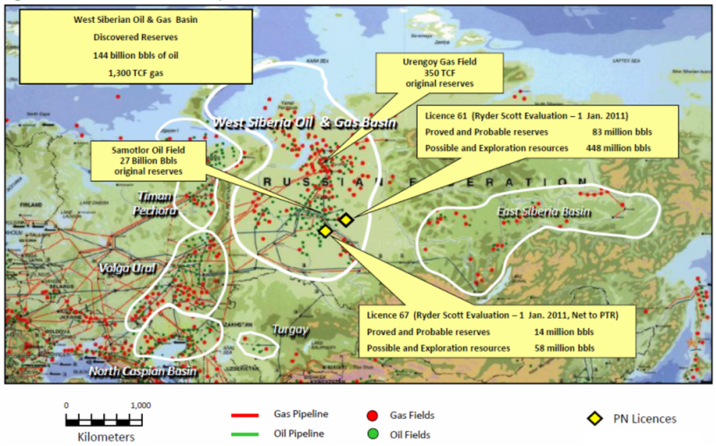
Property	Ledovoye	Cheremshanskaya
Reservoir	Upper Jurassic	Upper Jurassic
Depth top Reservoir, m	2,523	2,572
Porosity, %	14-20	14-21
Permeability, mD	3.2-41.7	3.5-65.6
Net pay, m	4.9-11.8	14.9
Hydrocarbon saturation, %	44-70	77

Source: Ryder Scott

Tomsk Region

We think it is important that PetroNeft is located in the hydrocarbon rich region of Russia with vast proved and potential reserves as well as a large number of small prospects that may be off the radar of the large integrated oil companies. Oil and gas production started in the Tomsk Region in the early-1960s. Total accumulated production has exceeded 2bn bbls, according to the administration of the Tomsk Region.

Figure 18: Possible and exploration resources



Source: PetroNeft

According to the administration of the Tomsk Region, crude oil reserves under Russian classification (C1+C2) amount to about 3bn bbls, which accounts for over 4% of total Russian reserves. The reserves base of the Tomsk Region is comparable to that of Syria or Yemen, while regional production exceeds that of Uzbekistan and is close to Turkmenistan production. The Tomsk Region also has rich gas and condensate reserves which stand at 324.7bcm (C1+C2) and 36.6mnt, respectively, which may rival gas reserves of the UK or Peru.

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 210kboepd and 4bcm 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 at about 50%), while the east of the Ob River area (where PetroNeft's first licence L61 is located) is underexplored and has significant exploration potential. According to the Russian Science Academy, potential oil resources in this area may range from between 600mnt and 1,000mnt. The long-term hydrocarbons production prospects of the Tomsk Region is largely 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).

Other companies that are active in the Tomsk Region include Rosneft and Gazprom Neft (through Tomskeneft as well as directly), ONGC, MOL, Gazprom and several small local producers.

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Johan Snyman	+27 (11)	750-1432	South Africa
Telecoms/Transportation			
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Ivan Kim	+7(495)	258-7770x5620	Russia/CIS, Africa
Alexandra Serova	+7 (495)	258-7770x4073	Russia/CIS
Johan Snyman	+27 (11)	750-1432	South Africa
Utilities			
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Vladimir Sklyar	+7 (495)	258-7770x4624	Russia/CIS
Luxury goods and tobacco			
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Ryno Truter	+27 (11)	750-1497	Africa
Quantitative analysis			
Renda Rundle	+44 (207)	367-8240	South Africa
Small and medium cap			
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Medium cap/Transport/Construction/Building materials			
John Arron	+27 (11)	750-1466	Africa
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Paper			
Adriana Benedetti	+27 (11)	750-1452	South Africa
Diversified industrials/Support services/Packaging			
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Regional research			
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