Southern Cross Equities

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Jupiter Energy (JPR)

Best value oil reserves on the ASX

Recommendation

Spec Buy

Price

$0.058

Target (12 months)

$0.18

JPR's new reserves report for its Kazakhstan oil discovery was released and it did not disappoint. The company owns 100% of a 24mmbbl oil project with good upside. The market values JPR's oil reserves at a low $3.26/barrel which is a huge discount to other mid cap oil & gas stocks. We maintain a TP of $0.18 and the market mispricing is a great buying opportunity.

Expected Return

Capital growth	**210%**
Dividend yield	**0%**
Total expected return	**210%**

Company Data & Ratios

Enterprise value	**$79m**
Market cap	**$88m**
Issued capital	**1,511m**
Free float	**73%**
12 month price range	**$0.027-0.073**
GICS sector	**Energy**

Kazakh oil reserves independently verified at 24mmbbl

JPR has announced that its Block 31 oil discovery has been independently certified to contain 24.2mmbbl which is a 180% increase from the 8.6mmbbl booked in January 2010. This incorporates the J52 oil well drilled 3.8km to the SE of the discovery at J50. Further reserves upside exists in the shallower Z sandstone and contingent resources further to the SE and to the north.

ASX investors don't get it – buy before AIM listing!

Despite the excellent reserves announcement, JPR's share price is virtually unchanged. The market effectively values the reserves at $3.26/bbl which is very low compared to other listed oil & gas companies. The average EV/bbl for 17 mid cap oil & gas stocks on the ASX is closer to $23/bbl. While we understand that Australian investors perceive Kazakhstan as high risk, we think there is little justification for it, and the discount is an excessive penalty. We believe an AIM listing in 2H 2011 should address that issue.

We have a Spec Buy on JPR, and the main thing we are speculating about is when will the market wake up to the value. The oil has been found, flow testing continues and a Trial Production License should be awarded soon.

Absolute Price

SOURCE: IRESS

Earnings Forecast

Year end June 30	2011E	2012E	2013E	2014E
Revenue ($m)	4.3	29.8	60.5	129.8
EBITDA ($m)	(3.6)	11.6	30.5	81.4
NPAT - underlying ($m)	(5.4)	(1.5)	3.8	26.0
EPS - reported (c/sh)	(0.5)	(0.1)	0.3	1.7
Gearing	13%	37%	41%	30%
PER (x)	-12.9x	-59.6x	23.0x	3.4x
EV/EBITDA	-21.1x	9.3x	3.8x	1.4x
Dividend (c/sh)	-	-	-	-
Yield (%)	-	-	-	-
ROE (%)	-15%	-4%	10%	49%

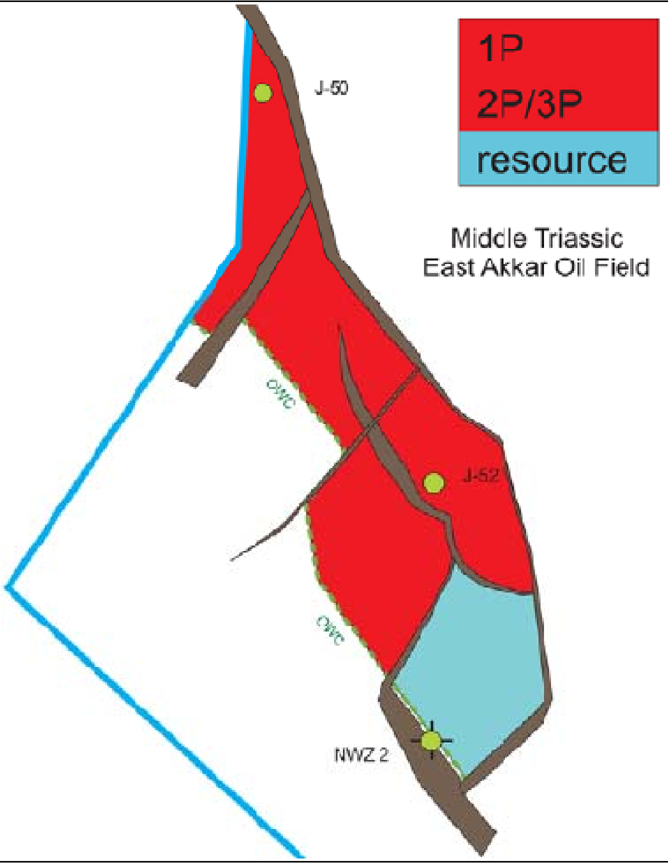
SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Reserves upgrade is a step change

24mmbbl is a very decent oil field

JPR owns 100% of Block 31 in Kazakhstan, and the upgrade of 2P reserves from 8.6mmbbl to 24.2mmbbl is an excellent result for the company. The opportunity to grow the reserves further is good, as the structure extends further to the south-east.

Figure 1 - Block 31 oil field



SOURCE: COMPANY DATA

Table 1 below reproduces Senergy Ltd's reserves report which is only for the mid Triassic reservoirs. It is important to note that it excludes the oil found in the Z sandstone reservoir in the J52 well.

Table 1 - JPR mid Triassic reserves & resources

		Reserves (mmbbl)			Prospective Resources (mmbbl)		
		1P	2P	3P	P90	P50	P10
Jan 2010	OIIP	21.4	31.0	43.0	24.6	52.0	92.0
	Recoverable	5.5	8.6	13.4	4.8	12.2	24.5
	Recovery factor	26%	28%	31%	20%	23%	27%
Apr 2011	OIIP	53.7	104.6	119.5	31.8	42.8	61.1
	Recoverable	9.8	**24.2**	32.1	6.3	9.9	15.3
	Recovery factor	18%	23%	27%	20%	23%	25%
	Reserves increase	79%	182%	139%	30%	-19%	-38%

SOURCE: COMPANY DATA / SENERGY LTD

Essentially, the 24mmbbl 2P reserve has been demonstrated by drilling the first two wells on Block 31. As can be seen in Table 1, Senergy has increased the Oil Initially In Place (OIIP) volume to 104.6mmbbl but reduced the recovery factor from 28% to 23%. We consider this to be a conservative step, particularly as the flow rate from J52 of 750bopd was better than expected. However, we support a conservative reserves calculation at this stage of evaluation. Interestingly, if Senergy had maintained a 28% recovery factor, it would have added 5mmbbl to JPR's reserves.

The prospective resources at the P50 and P10 levels have decreased as a significant proportion has been transferred to reserves. However, if we add the 3P and P10 categories together the potential recoverable reserves have increased by 25%, from 37.9mmbbl to 47.4mmbbl.

Note that the current estimates have ignored the oil found in the Z sandstone reservoir which overlies the mid Triassic and additional reserves upside exists to the north of the J50 and the adjacent North Akkar oil field. A reserves estimate for the Z sand will be done after the 90 day test anticipated in Q3 2011. Drilling the prospect to the north of J50 is not anticipated until 2012 or later.

No change to our estimates at this stage

We have assumed a 25mmbbl oil reserve on Block 31 since we initiated coverage on 3 March 2011. We had a notional 20mmbbl for the mid Triassic and 5 mmbbl for the Z sandstone. While the 24.2mmbbl reserve for the mid Triassic is a better outcome than we had assumed, we are leaving our reserve estimates unchanged until we get confirmation of commercial flow rates from the Z sand.

Peer group comparison

The market value for reserves is an imperfect measure to value an oil & gas stock but it does highlight a huge range of valuations. We have updated our table of Enterprise Values for 2P reserves of the mid cap stocks.

As shown in Table 2 over the page, JPR is very lowly valued by the market at the current share price, and we cannot see this sustained for any length of time. NXS is the second cheapest stock on the list and we argue that it is overly discounted too, but there are some question marks over the Longtom reserves and how Crux will be commercialised. No such question marks exist for JPR, particularly following the Senergy report.

Table 2 - Reserves valuations for mid cap oil & gas stocks

		EV	2P	
		$m	mmboe	$/boe
Jupiter Energy	JPR	79	24.2	$3.26
Nexus Energy	NXS	708	113.0	$6.26
Carnarvon Petroleum	CVN	207	24.0	$8.61
AWE	AWE	743	65.0	$11.43
Roc Oil	ROC	219	18.9	$11.60
Senex Energy	SXY	245	18.6	$13.18
Petsec	PSA	36	2.7	$13.33
Beach Energy	BPT	956	66.0	$14.49
Innamincka Pet	INP	66	3.8	$17.53
Cooper Energy	COE	39	2.2	$17.57
Tap Oil	TAP	133	5.8	$22.93
Cue Energy	CUE	239	9.4	$25.42
Horizon Oil	HZN	407	14.7	$27.72
Nido Petroleum	NDO	124	4.0	$30.84
Aurora Oil & Gas	AUT	1,062	22.1	$48.04
Eureka Energy	EKA	80	1.6	$50.04
Texon Petroleum	TXN	147	2.2	$68.19
Average				$22.97

SOURCE: COMPANY AND SOUTHERN CROSS EQUITIES ESTIMATES

Upcoming news flow

The share price reaction to the reserves announcement is very disappointing and does not make sense to us. While the market knew that an updated reserves report was due, it cannot be described as a disappointing result.

We believe that JPR is outstanding value at the current share price and upcoming news flow should lend further support to a higher market valuation:

- Award of a Trial Production License (TPL) for J50. This was expected in March but the Government Department issuing such a License has been re-organised, which has led to delays. It should be awarded in April.
- Extension of Block 31 is also awaited shortly, which will almost double the size of the License. This will allow drilling of a potential extension of the oil discovery further to the south-east of J52.
- Flow testing of the mid Triassic section at J52 will continue until late May, and confirmation of a high sustained flow rate of 6-700bopd would be very positive for project economics as we have used a 450bopd starting assumption per well. This is a key valuation sensitivity for the stock.
- Flow testing of the Z sandstone reservoir will commence in June. A decent flow rate will generate another reserves increase and warrant re-entry of the Soviet well NWZ2 which had 30m net oil reservoir in a 35m Z sandstone.
- A re-fraccing of J50 is contemplated following the success of J52. If J50 can also be made to flow at 6-750bopd it would be very positive for production and cash flow.
- Provide a time frame for the planned AIM listing in the UK. We expect this to

occur in 2H 2011 and would raise enough equity funds to undertake a development of the oil project shaping up in Block 31. We anticipate a raising of +$30m as we discussed in our initiation report of 3 March 2011.

- The market reaction to the reserves report is another pointer that an AIM listing is necessary. The UK market has much greater familiarity with companies operating in Kazakhstan compared to Australian investors. This includes mid cap petroleum stocks like Tethys, Max and Roxi while mining companies such as Kazakhmys Plc and Eurasian Natural Resources are capitalised at £7.7B and £12.4B respectively. We share the company's view that the UK market will price JPR's shares more accurately.

Summary and recommendation

JPR is an oil stock focused on Kazakhstan which we value at $0.18/share. The latest 24mmbbl reserves report is independently certified by Senergy. We believe there is upside from this level. The result is broadly consistent with our 25mmbbl reserves assumption, and supports our investment thesis.

This 182% increase in reserves follows the recent positive announcement that oil at the J52 well was flowing at 750bopd, which was much higher than the company's original guidance of 500bopd.

The oil project in Block 31 is being significantly de-risked, but the market is not recognising the positive changes underway. While disappointing, it provides investors with an ongoing investment opportunity as JPR is demonstrably undervalued and we maintain a Spec Buy recommendation.

COMPANY DESCRIPTION

JPR is an oil company with a single asset in Kazakhstan. Block 31 in the Mangistau basin is 100% owned and has drilled two successful oil wells to date. Reserves for the first two wells have been independently certified by Senergy Australia at 24.2mmbbl in the mid Triassic reservoirs. Additional reserves of 5-10mmbbl may exist in the younger Z-sandstone but this is yet to be confirmed.

The oil is mainly found in mid Triassic reservoirs of low to average quality, and neighbouring oil fields show low recovery factors of the oil in place but long life, low decline rates for these types of wells.

INVESTMENT STRATEGY

The company is enhancing its first two oil wells through fraccing and will prepare a field development plan based on the results of these tests. The reservoir is well suited to fraccing which will maximise productivity and reserves recovery. Further enhancements are possible through horizontal production wells. Enhanced recovery factors from oil-in-place of over 100mmbbl plus extensions of the existing license to the east represent future growth options in the short to medium term.

Longer term, the company will use its cash flow from Block 31 to expand into new licenses in Kazakhstan. The Board and management of JPR are very well connected and will look to grow the company from the current modest base.

VALUATION

Our valuation of JPR is $0.18/share. This is based on the assumption of a 25mmbbl oil field worth $0.14/share plus resource potential of 85mmbbl currently valued at $1/bbl or $0.06/share. Cash of $6m represents $0.01/share while corporate overheads deduct $0.03/share.

RISKS

JPR faces normal oil and gas industry risks, and has some more specific issues:

- Prices for oil are inherently volatile, and strongly linked to the world economy and market conditions. JPR is highly leveraged to oil prices.
- Project execution is always a risk, and to manage a project in Kazakhstan as an Australian company presents some challenges. However, the local operating office and staff appear very well qualified to do the job.
- Kazakhstan political risks exist although perception is much higher than the reality. Regulatory and administrative issues such as procurement need to be managed properly.
- Operational and environmental risks are high in the oil and gas industry, with high safety standards required to avoid explosions, fires, oil spills etc. The Mangistau basin is primarily an oil producing region with no competing land use as it is a desert.
- Financing issues exist as JPR does not have the balance sheet or cash flow to fund the development of Block 31. JPR is planning to list the company's shares on the UK AIM market which will raise equity for the development.

Jupiter Energy
as at 6 April 2011

Recommendation	Spec Buy
Price	$0.058
Target (12 months)	$0.18

Table 3 - Financial summary

PROFIT AND LOSS

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
Revenue	$m	4	30	61	130
Operating expense	$m	(8)	(18)	(30)	(48)
EBITDA	$m	**(4)**	**12**	**30**	**81**
Depreciation	$m	(0)	(2)	(4)	(8)
EBIT	$m	**(4)**	**9**	**26**	**74**
Net interest expense	$m	0	0	0	1
PBT	$m	**(4)**	**10**	**27**	**75**
Tax expense	$m	(2)	(11)	(23)	(49)
NPAT (underlying)	$m	**(5)**	**(1)**	**4**	**26**
Abnormal items	$m	-	-	-	-
NPAT (reported)	$m	**(5)**	**(1)**	**4**	**26**

CASH FLOW

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
OPERATING CASHFLOW					
NPAT	$m	(5)	(1)	4	26
Add: non-cash items	$m	0	2	6	10
Change in working capital	$m	(1)	(4)	(5)	(10)
Operating cashflow	$m	**(6)**	**(3)**	**6**	**26**
INVESTING CASHFLOW					
Net PP&E	$m	(19)	(12)	(10)	(21)
Exploration & evaluation	$m	-	-	(5)	(5)
Other	$m	-	-	-	-
Investing cash flow	$m	**(19)**	**(12)**	**(15)**	**(26)**
FINANCING CASHFLOW					
Share capital	$m	18	-	2	-
Short term investments	$m	-	-	-	-
Dividends paid	$m	-	-	-	-
Interest-bearing debt	$m	7	23	17	21
Financing cash flow	$m	**25**	**23**	**19**	**21**
Change in cash	$m	(0)	8	9	21

BALANCE SHEET

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
ASSETS					
Cash	$m	1	9	18	39
Accounts receivable	$m	1	9	18	39
Oil & gas properties	$m	19	29	35	48
Exploration & evaluation assets	$m	22	22	25	27
Short term investments	$m	-	-	-	-
Other	$m	0	0	0	0
Total assets	$m	**44**	**70**	**97**	**154**
LIABILITIES					
Accounts payable	$m	0	3	6	13
Tax payable	$m	0	1	3	6
Borrowings	$m	7	29	46	67
Provisions	$m	0	0	0	0
Other	$m	1	1	1	1
Total liabilities	$m	**8**	**35**	**56**	**87**
SHAREHOLDER'S EQUITY					
Share capital	$m	63	63	65	65
Retained earnings	$m	(29)	(30)	(26)	(0)
Reserves	$m	2	2	2	2
Total equity	$m	**36**	**35**	**40**	**66**
Weighted average NoSh	m	1,199	1,511	1,511	1,511

PRODUCTION

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
Total	mmboe	49	329	624	1,186

FINANCIAL RATIOS

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
VALUATION					
Reported NPAT	$m	(5)	(1)	4	26
Underlying NPAT	$m	(5)	(1)	4	26
Reported EPS	c/sh	(0.5)	(0.1)	0.3	1.7
EPS growth	%		-78%	-359%	583%
PER	x	-12.9x	-59.6x	23.0x	3.4x
OpCFPS (ex. abnormals)	c/sh	(0.5)	(0.2)	0.4	1.7
Price/OpCFPS	x	-12.4x	-27.4x	15.4x	3.4x
DPS	c/sh	-	-	-	-
Yield	%	-	-	-	-
EV/EBITDA	x	-21.1x	9.3x	3.8x	1.4x
PROFITABILITY RATIOS					
EBITDA margin	%	-83%	39%	50%	63%
EBIT margin	%	-91%	32%	44%	57%
Return on assets	%	-12%	-3%	5%	21%
Return on equity	%	-15%	-4%	10%	49%
Dividend cover	x	-	-	-	-
LIQUIDITY & LEVERAGE					
Net debt (ND) / (cash)	$m	5	21	28	28
ND / E	%	15%	59%	70%	42%
ND / (ND + E)	%	13%	37%	41%	30%

ASSUMPTIONS

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
Oil price (Brent)	US$/bbl	97.5	97.5	100.0	100.6
AUD / USD		0.98	0.94	0.90	0.80

SUM-OF-PARTS

2011E valuation	Gross mmbbl	Net mmbbl	NPV ($m)	$/boe	$/sh
Block 31 likely reserve (2P+2C)	25.0	25.0	222	8.88	0.14
Block 31 contingent resources (3C)	85.0	85.0	85	1.00	0.06
Total Reserves & Resources	**110.0**	**110.0**	**307**	**2.79**	**0.20**
(Net debt) / cash			9.0		0.01
Corporate costs			(45)		(0.03)
Equity value			**271**		
Diluted NoSh (m)			1,539		
Total					**0.18**

VALUATION SENSITIVITIES

OIL PRICE		US$/bbl	A$m	A$/sh	% diff
	Base	97.5	271	0.18	
-10%	Low	87.8	224	0.15	-17%
+10%	High	107.3	316	0.21	17%
EXCHANGE RATE (long term)		AUD/USD	A$m	A$/sh	% diff
	Base	0.80	271	0.18	
+0.1	Low	0.90	210	0.14	-23%
-0.1	High	0.70	347	0.23	28%
WACC (post tax)		%	A$m	A$/sh	% diff
	Base	12%	271	0.18	
	Low	13%	253	0.16	-6%
	High	11%	291	0.19	7%

EPS SENSITIVITIES

OIL PRICE		2011E	2012E	2013E	2014E
US$97.5/bbl	Base	(0.5)	(0.1)	0.3	1.7
-10%	Low	(0.5)	(0.2)	0.0	1.3
+10%	High	(0.4)	0.0	0.4	2.1
EPS	Low	5%	118%	-81%	-26%
	High	-4%	-102%	77%	24%

SOURCE: SOUTHERN CROSS EQUITIES ESTIMATES

Recommendation structure

Spec Buy: Expect >30% total return on a 12 month view but carries significantly higher risk than its sector

Buy: Expect >15% total return on a 12 month view

Accumulate: Expect total return between 5% and 15% on a 12 month view

Hold: Expect total return between -5% and 5% on a 12 month view

Reduce: Expect total return between -15% and -5% on a 12 month view

Sell: Expect <-15% total return on a 12 month view

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Southern Cross Equities Ltd and its associates hold 11,976,000 shares in JPR as at the date of this report. This position is subject to change without notice..

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