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Jupiter Energy (JPR)

Action in Kazakhstan picking up

Recommendation
Spec Buy (unchanged)
Price
$0.051
Target (12 months)
$0.14 (unchanged)

Expected Return	
Capital growth	175%
Dividend yield	0%
Total expected return	175%
Company Data & Ratios	
Enterprise value	$77m
Market cap	$89m
Issued capital	1,766m
Free float	70%
Avg. daily vol. (52wk)	(9.2m)
12 month price range	$0.027-0.078
GICS sector	Energy

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	0.05	0.06	0.03
Absolute (%)	0.0	-12.1	53.8
Rel market (%)	-1.4	-5.6	45.3

Activities re-starting in Kazakhstan

JPR has announced that testing of the Jurassic reservoir in well J-52 has commenced, and that a drilling program of three wells back-to-back will start at the end of July. This signals a period of higher activity which should be good for the share price which has been muted for the last couple of months. The company has also called an EGM to approve the recent placement, consolidate the share capital on a 15 for 1 basis and to approve new performance rights to key personnel. We reiterate our Spec Buy recommendation with a $0.14 target.

No changes to estimates

We have not revised our estimates to JPR's production, earnings or valuation. The $0.14 valuation is largely based on the certified 24.2mmbbl of 2P reserves in Block 31, which we value at a conservative $7.60/bbl or $0.11/share. Possible reserves and net cash bring the valuation to $0.14.

Investment view remains positive

We maintain a Spec Buy recommendation, and the "Speculative" rating is mainly related to the fact that Kazakhstan is perceived to be a politically risky place to operate. Following a visit to the country and the company's operations earlier this year, we do not agree with this market perception but we acknowledge that it exists.

While we do not expect the testing of J-52's Jurassic reservoir to flow oil at high rates, any flow rate would be a bonus to the Triassic reservoirs which tested up to 849bopd. It would also encourage JPR to re-enter the nearby Soviet era NWZ-2 well which recorded a thicker oil column over the same Jurassic interval, but wasn't tested.

Re-starting a drilling campaign with J-51 located between the two existing wells is a low risk target which is designed to increase the confidence in the 1P and 2P reserves and demonstrate that the improved flow rates in J-52 from a light fracc can be repeated at another location. The share consolidation ahead of a listing on London's AIM market makes sense, to address the "penny dreadful" status.

Absolute Price

SOURCE: IRESS

Earnings Forecast

Year ending 30 Jun	2011E	2012E	2013E	2014E
Revenue ($m)	1.4	26.2	55.7	110.9
EBITDA ($m)	(5.4)	8.8	26.8	64.5
NPAT - reported ($m)	(6.0)	(3.0)	1.7	15.0
NPAT - adjusted ($m)	(6.0)	(3.0)	1.7	15.0
EPS - reported (c/sh)	(0.5)	(0.2)	0.1	0.9
EPS growth (%)		-62%	-155%	797%
PER (x)	-11.1x	-29.4x	53.1x	5.9x
FCF yield (%)	-36%	-19%	-13%	-10%
EV/EBITDA	-12.2x	11.3x	4.0x	1.8x
Dividend (c/sh)	-	-	-	-
Yield (%)	-	-	-	-
ROE (%)	-13%	-7%	4%	27%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Coming out of a lull in activity

It is good to see that key shareholders and directors are strong supporters of the stock

A little bit quiet on the Kazakh front but some good signs

JPR has been relatively quiet in the last few months, following the excellent flow rates reported from the Triassic reservoirs in the J-52 well late April. An equity raising of $11m through the issue of 226.5m shares at $0.049 was done in May, with the Waterford Group increasing its stake to 29.8% and a new substantial shareholder emerging through Soyuzneftegas at 7.1%. We also note that non-executive director Alastair Beardsall (and a director of the Waterford Group) bought 10m shares for his personal pension account in June. It is good to see that key shareholders and directors are strong supporters of the company and reflects growing confidence in the value of the stock.

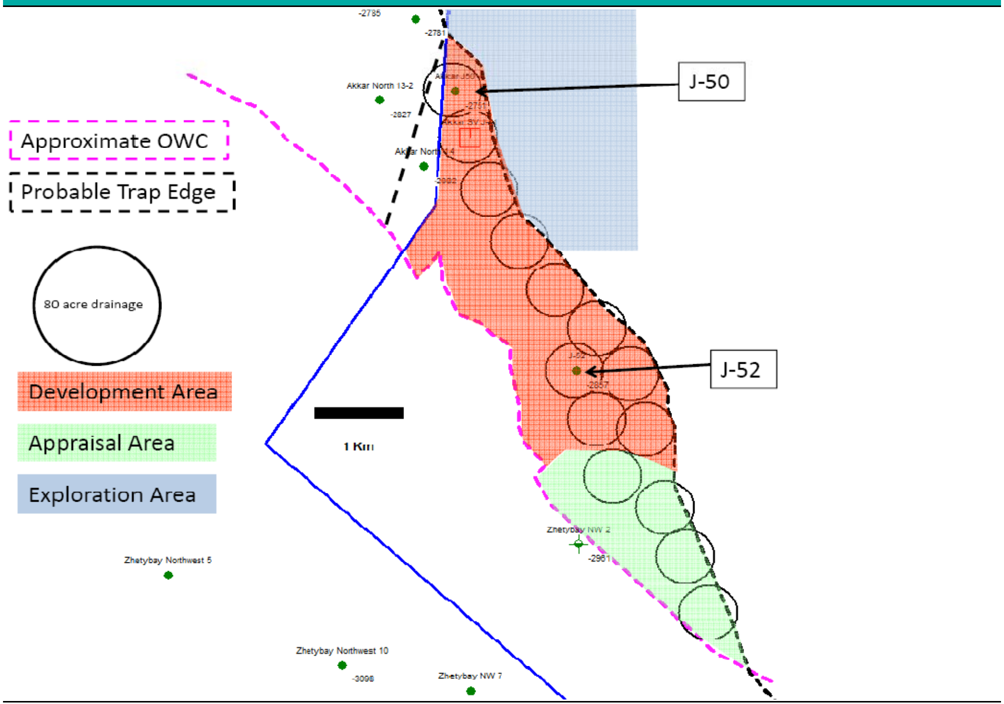
If the Jurassic reservoir can flow oil it would be a bonus in two ways: More reserves and cash flow plus upside in an old Soviet era well

Testing and more drilling ahead

The company has started testing the so-called Z sandstone unit of Jurassic age in the J-52 well, which overlies the main reservoir in the Mid Triassic. Oil shows were recorded over a 29m section, with 9m of net reservoir now being fracced and tested. If this reservoir can flow oil at, say 100bopd, it would be a bonus in two ways. Firstly it would add to the reserves and the cash flow from an existing well. Secondly and perhaps more importantly it would encourage the company to re-enter and test the Soviet era well at NWZ-2 which had a 35m thick Z sandstone with oil shows over 30m of interpreted net pay. This provides another upside risk to our valuation of JPR as we have only assumed about 1mmbbl from the Jurassic, while the potential could be in the tens of mmbbl.

JPR has awarded FracJet the contract to drill three wells back-to-back starting this month. This is the same drilling contractor that drilled the J-52 well and achieved significantly improved drilling performance and flow rates from the reservoir, compared to the J-50 well.

Figure 1 - Block 31 Mangistau basin Kazakhstan



SOURCE: COMPANY DATA

- J-51 will be between the two existing wells, and is a low risk well designed to boost the confidence in the reserves and to demonstrate that the good oil flows from fraccing the Triassic reservoir in J-52 can be repeated at another location.
- J-53 will be drilled to the south-east of J-52 to extend the known southern limits of the oil field. This will increase both 2P and 3P reserves in the success case and has a bit more risk than J-51 but should not be considered particularly risky.
- The final well in this drilling program is J-54 located even further to the south-east. This last well is expected to be drilled in an extension area to Block 31 that JPR has applied for, with the process nearing completion. This is more of an exploration well, but the seismic indicates a continuation of the trend and the success case would have a significant impact on reserves estimates.

While JPR only has about $11m cash at present, we expect a significant equity raising on London's AIM in September-October

Each well is expected to take three months to drill, complete and test at a cost of $15m, a 25% saving on the previous well costs. While JPR only has about $11m cash at present, we expect a significant equity raising on London's AIM in September-October. A good flow rate from the Jurassic in J-52 and a good result from J-51 will be key to the AIM listing.

License approvals and extensions to come

JPR has suffered delays to its Trial Production License (TPL) for the J-50 well due to its proximity to the North Akkar field owned by MangistauMunaiGas (MMG). We understand that progress is being made, but the company is reluctant to provide a timing estimate.

A separate TPL application has been lodged for J-52 and it is progressing quite well and could possibly be approved before the J-50 TPL. Once a TPL has been granted, it enables the company to sell at least 80% and possibly up to 100% of its oil to the export market rather than through the discounted Domestic Market Obligation. A TPL is valid for three years and is normally followed by Full Field Development (FFD) approval.

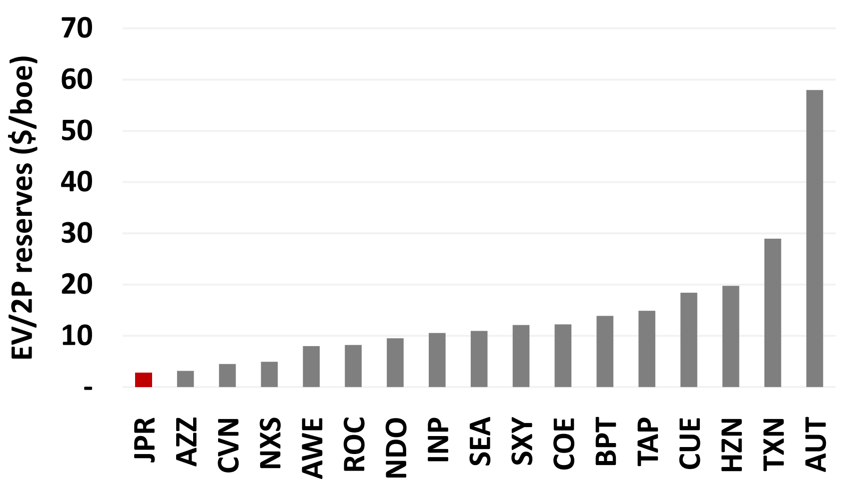
A license extension of Block 31 is also progressing well according to the company and an announcement is expected shortly. This would increase the size of Block 31 by about 80% and add significant reserves potential. This potential will be evaluated through the drilling of J-54, probably about February-March 2012.

Stock is cheap on reserves valuation

On a simplistic measure JPR is the cheapest stock on the ASX as far as we know

On the simplistic measure of EV/bbl of 2P reserves, JPR is the cheapest stock on the ASX as far as we know. This reinforces our investment view that the stock is undervalued.

Figure 2 - EV/boe for selected ASX oil & gas stocks



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

EGM to vote on share consolidation and performance rights

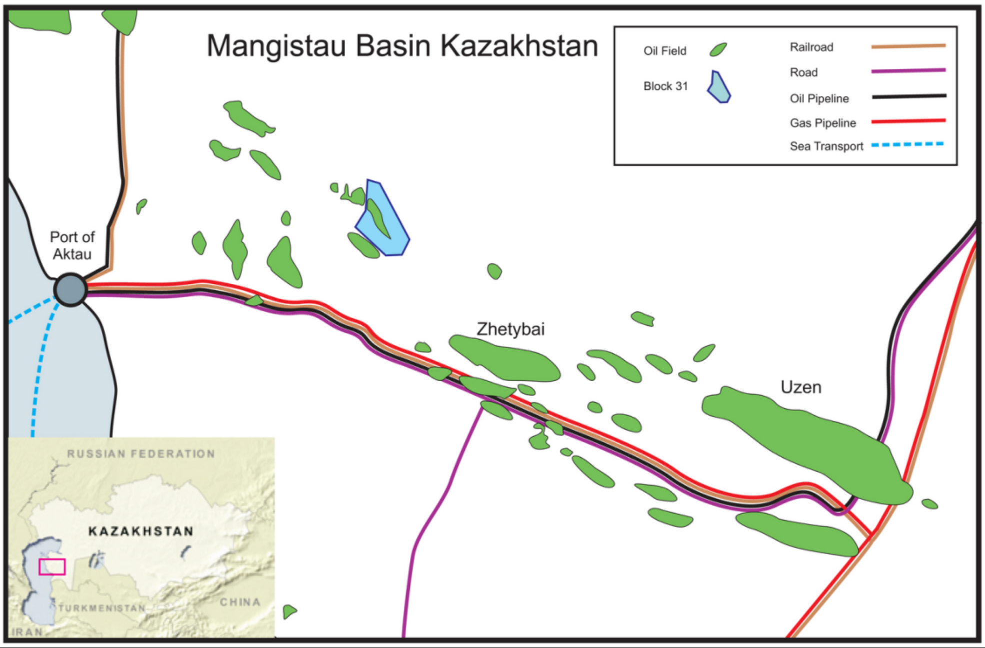
JPR has called an EGM for August 12, 2011 to approve a 15:1 share consolidation. The company has 1,738 million shares on issue which would be crunched to 115.9m shares. Existing options will be consolidated on the same ratio. This is a good move in our view as it will remove the "penny dreadful" status to shares trading in the 5¢ region and the stock would become a less attractive proposition for the day traders that have been active in the stock.

The EGM is also seeking approval for the recent placement of 226.5m shares, representing 15% of issued capital. The placement raised $11.4m and was done at $0.049 to major shareholders Waterford Group, Soyuzneftegas and some new UK institutional investors.

Shareholders will also be asked to approve the issue of performance rights to key personnel. These will vest at nil consideration if the share price increases by more than 25% in the 12 months after the issue, with a proportional vesting above that level. Eg. if the share price increases by 50%, then half the performance rights will be vested, if the price increases by 100% or more, then 100% will vest. We consider the threshold of 25% a bit low considering that the share price was above this level recently, and in view of our valuation. But it will be up to shareholders to decide whether the terms of these performance rights are too generous or not.

The Mangistau basin is a prolific oil region with billions of barrels of reserves

Figure 3 - Map of Mangistau basin and Block 31 Kazakhstan



SOURCE: COMPANY DATA

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 1-10mmbbl 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 has enhanced its second oil well through fraccing and will prepare a field development plan based on the results of the next round of drilling and testing three wells. The reservoir is well suited to fraccing which will maximise productivity and reserves recovery. Further enhancements may be possible through horizontal production wells but the company is not contemplating this approach yet. Enhanced recovery factors from oil-in-place of over 100mmbbl plus extensions of the existing license to the south-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 $0.14/share. This is based on the assumption of a 25mmbbl oil field worth $0.11/share plus resource potential of 85mmbbl currently valued at $1/bbl or $0.05/share. Cash of $11m represents $0.01/share while corporate overheads deduct $0.03/share.

An EGM has been called for 12 August 2011 seeking shareholder approval for a share consolidation of 1 for 15 to reduce the very large capital structure of 1.7B pieces of paper.If this is approved, the share price equivalent of $0.05 = $0.75 and our valuation would be $2.05 rather than $0.14/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 7 July 2011

Recommendation	Spec Buy
Price	$0.051
Target (12 months)	$0.14

Table 1 - Financial summary

PROFIT AND LOSS

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
Revenue	$m	1	26	56	111
Operating expense	$m	(7)	(17)	(29)	(46)
EBITDA	$m	**(5)**	**9**	**27**	**64**
Depreciation	$m	(0)	(2)	(4)	(8)
EBIT	$m	**(6)**	**7**	**23**	**57**
Net interest expense	$m	0	0	0	1
PBT	$m	**(6)**	**7**	**23**	**58**
Tax expense	$m	(1)	(10)	(21)	(43)
NPAT (underlying)	$m	**(6)**	**(3)**	**2**	**15**
Abnormal items	$m	-	-	-	-
NPAT (reported)	$m	**(6)**	**(3)**	**2**	**15**

CASH FLOW

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
OPERATING CASHFLOW					
NPAT	$m	(6)	(3)	2	15
Add: non-cash items	$m	0	2	6	10
Change in working capital	$m	(0)	(4)	(4)	(8)
Operating cashflow	$m	**(6)**	**(5)**	**4**	**17**
INVESTING CASHFLOW					
Net PP&E	$m	(18)	(12)	(10)	(21)
Exploration & evaluation	$m	-	-	(5)	(5)
Other	$m	-	-	-	-
Investing cash flow	$m	**(18)**	**(12)**	**(15)**	**(26)**
FINANCING CASHFLOW					
Share capital	$m	29	-	2	-
Short term investments	$m	(6)	6	-	-
Dividends paid	$m	-	-	-	-
Interest-bearing debt	$m	-	18	18	25
Financing cash flow	$m	**23**	**24**	**20**	**25**
Change in cash	$m	(1)	7	9	17

BALANCE SHEET

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
ASSETS					
Cash	$m	0	8	17	33
Accounts receivable	$m	0	8	17	33
Oil & gas properties	$m	18	28	34	47
Exploration & evaluation assets	$m	22	22	25	27
Short term investments	$m	6	-	-	-
Other	$m	0	0	0	0
Total assets	$m	**48**	**66**	**93**	**141**
LIABILITIES					
Accounts payable	$m	0	3	6	11
Tax payable	$m	0	1	3	6
Borrowings	$m	-	18	36	62
Provisions	$m	0	0	0	0
Other	$m	1	1	1	1
Total liabilities	$m	**1**	**23**	**46**	**79**
SHAREHOLDER'S EQUITY					
Share capital	$m	74	74	76	76
Retained earnings	$m	(29)	(32)	(31)	(16)
Reserves	$m	2	2	2	2
Total equity	$m	**47**	**44**	**47**	**62**
Weighted average NoSh	m	1,312	1,738	1,738	1,738

PRODUCTION

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
Total	000 bbl	16	329	624	1,186

FINANCIAL RATIOS

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
VALUATION					
Reported NPAT	$m	(6)	(3)	2	15
Underlying NPAT	$m	(6)	(3)	2	15
Reported EPS	c/sh	(0.5)	(0.2)	0.1	0.9
EPS growth	%		-62%	-155%	797%
PER	x	-11.1x	-29.4x	53.1x	5.9x
OpCFPS (ex. abnormals)	c/sh	(0.5)	(0.3)	0.2	1.0
Price/OpCFPS	x	-11.1x	-19.1x	23.8x	5.3x
DPS	c/sh	-	-	-	-
Yield	%	-	-	-	-
EV/EBITDA	x	-12.2x	11.3x	4.0x	1.8x
PROFITABILITY RATIOS					
EBITDA margin	%	-402%	33%	48%	58%
EBIT margin	%	-410%	25%	41%	51%
Return on assets	%	-13%	-5%	2%	13%
Return on equity	%	-13%	-7%	4%	27%
Dividend cover	x	-	-	-	-
LIQUIDITY & LEVERAGE					
Net debt (ND) / (cash)	$m	(0)	10	20	29
ND / E	%	-1%	23%	42%	46%
ND / (ND + E)	%	-1%	19%	29%	31%

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		1.03	1.07	0.98	0.94

SUM-OF-PARTS

2011E valuation	Gross mmbbl	Net mmbbl	NPV ($m)	$/boe	$/sh
Block 31 certified reserve (2P)	24.2	24.2	190	7.85	0.11
Block 31 contingent resources (3C)	85.0	85.0	85	1.00	0.05
Total Reserves & Resources	**109.2**	**109.2**	**275**	**2.52**	**0.16**
(Net debt) / cash			11.4		0.01
Corporate costs			(45)		(0.03)
Equity value			**241**		
Diluted NoSh (m)			1,766		
Total					**0.14**

VALUATION SENSITIVIES

OIL PRICE		US$/bbl	A$m	A$/sh	% diff
	Base	97.5	241	0.14	
-10%	Low	87.8	200	0.11	-17%
+10%	High	107.3	286	0.16	19%
EXCHANGE RATE (long term)		**AUD/USD**	**A$m**	**A$/sh**	**% diff**
	Base	0.85	241	0.14	
+0.1	Low	0.95	197	0.11	-18%
-0.1	High	0.75	294	0.17	22%
WACC (post tax)		**%**	**A$m**	**A$/sh**	**% diff**
	Base	12%	241	0.14	
	Low	13%	226	0.13	-6%
	High	11%	259	0.15	7%

EPS SENSITIVITIES

OIL PRICE		2011E	2012E	2013E	2014E
US$97.5/bbl	Base	(0.5)	(0.2)	0.1	0.9
-10%	Low	(0.5)	(0.3)	(0.1)	0.5
+10%	High	(0.5)	(0.1)	0.3	1.2
EPS	Low	1%	50%	-166%	-38%
	High	-1%	-43%	160%	36%

SOURCE: BELL POTTER SECURITIES 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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