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Jupiter Energy (JPR)

Share consolidation of 1 for 15

Recommendation
Spec Buy (unchanged)
Price
$0.645
Target (12 months)
$2.42 (previously $0.14)

Expected Return	
Capital growth	275%
Dividend yield	0%
Total expected return	275%
Company Data & Ratios	
Enterprise value	$61m
Market cap	$75m
Issued capital	116m
Free float	69%
Avg. daily vol. (52wk)	8.2m
12 month price range	$0.41-$1.17
GICS sector	Energy

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	0.74	0.71	0.53
Absolute (%)	-12.24	-8.51	22.51
Rel market (%)	-7.08	0.37	26.72

Issued capital crunched from 1.8B shares to 116m

JPR held its EGM last Friday which approved a 1 for 15 share consolidation, with 95% of shares voted in favour. This is a good move in our opinion as such a massive capital structure becomes unwieldy and the stock trades as a "penny dreadful".

Valuation changed to $2.42

Our previous valuation of JPR was $0.14, which on a straight 1 for 15 consolidation should translate to a $2.10 value. However, we have taken the opportunity to roll forward our NPV to mid 2012 which has increased the Target Price to $2.42. This simply reflects the fact that some of the capex is spent and the predicted growth in production is one year closer.

Drilling in Kazakhstan has resumed

JPR has resumed drilling in Block 31 of the Mangistau basin in Kazakhstan. The J-51 well is a low risk appraisal well situated between the two discovery wells J-50 and J-52. It is designed to confirm the productivity of the Triassic reservoir which flowed at 516bopd in J-52, a significant increase from the 350bopd tested in J-50 (both on an 8mm choke). Two more wells are planned after J-51, including J-53 an appraisal well to the south-east and J-54. The latter is more of an exploration well in the new south-easterly extension of Block 31. The exact location of J-54 will depend on new 3D seismic to be shot in the near term.

Certified reserves don't come much cheaper than this

JPR is an undervalued Spec Buy with 2P certified reserves of 24.2mmbbl plus significant resource upside. Our DCF valuation of the 2P reserves is $9.65/bbl and represents $1.96/share. The resource potential of an estimated 85mmbbl does not appear high risk, but requires drilling. The current share price effectively values the certified reserves at $2.52/bbl and the 85mmbbl potential at $0.72/bbl. We understand there is a perception of political risk in Kazakhstan but the discount is excessive in our view. JPR are currently trading as deferred settlement (JPRDA) until 29 August 2011.

Absolute Price

SOURCE: IRESS

Earnings Forecast

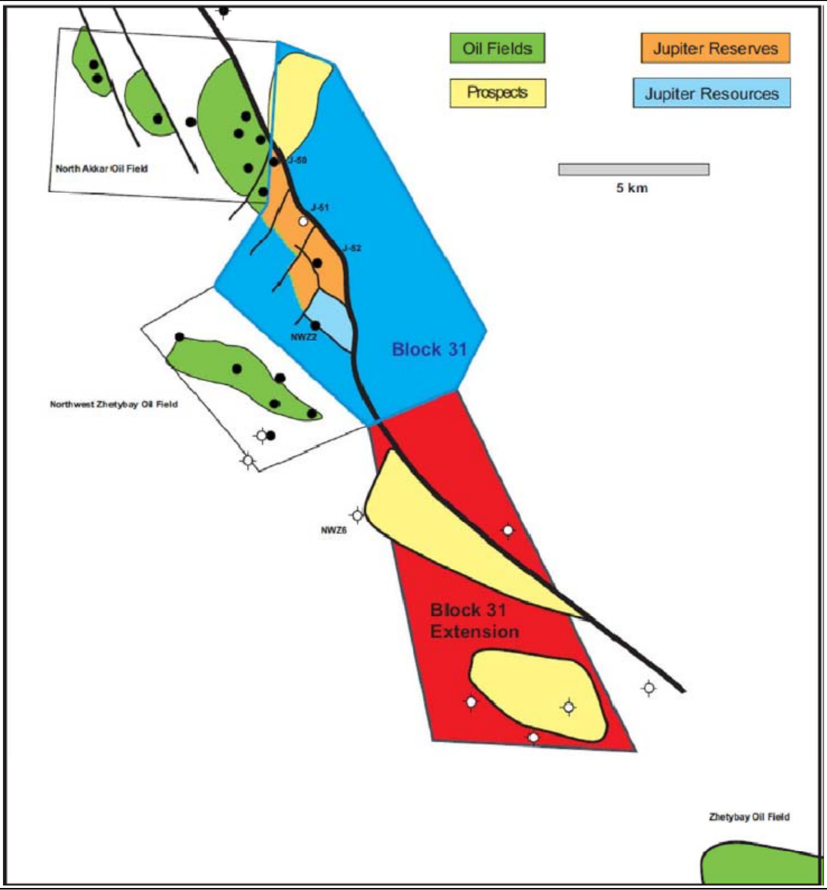
Year ending 30 Jun	2011E	2012E	2013E	2014E
Revenue ($m)	1.4	26.2	55.7	110.9
EBITDA ($m)	(5.4)	8.8	26.8	64.5
NPAT - reported ($m)	(6.0)	(3.0)	1.7	15.0
NPAT - adjusted ($m)	(6.0)	(3.0)	1.7	15.0
EPS - underlying (c/sh)	(0.5)	(2.6)	1.4	12.9
EPS growth (%)		467%	n.m	797%
PER (x)	-140.8x	-24.8x	44.8x	5.0x
FCF yield (%)	-3%	-22%	-15%	-12%
EV/EBITDA	-154.1x	9.7x	3.5x	1.6x
Dividend (c/sh)	-	-	-	-
Yield (%)	-	-	-	-
ROE (%)	-13%	-7%	4%	27%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Good news flow from Kazakhstan

More action on the ground in Kazakhstan

Figure 1 - Block 31 Mangistau basin, Kazakhstan



SOURCE: COMPANY DATA

JPR has recommenced a drilling campaign of three wells, with each well expected to take about 3 months to drill, frack and complete for production.

- J-51 has commenced and is a low risk appraisal located between the oil discovered in J-50 and J-52. The impact on reserves is not expected to be significant, other than increasing the proportion of 1P reserves and a slight increase in 2P reserves.
- The most important objective is to demonstrate the flow capability of the Triassic reservoir, which was very successfully fracked in J-52 compared to J-50, showing a 47% improvement in flow rate to 512bopd on an 8mm choke. The well also tested a high 849bopd on a 12mm choke, but the Kazakh authorities are unlikely to allow the field to be produced at such high rates until they become confident that this will not impact the ultimate reserves recovery. The company's view (and ours) is that the wells will eventually be allowed to produce at higher rates but this represents some upside for the longer term. We have assumed an initial production rate per well at 450bopd.
- J-53 will be drilled to the south-east of J-52, within the light blue area on the map above. The purpose of this well is to increase the 2P and 3P reserves by 5-10mmbbl and to confirm an overall oil field with a base of at least 30mmbbl.

- J-54 is planned for the large fault bound structure in the extension of Block 31. A 3D seismic program is about to commence and the best location for J-54 will be chosen when this data is processed and interpreted. This is more of an exploration well but the risks do not appear that high considering the structural setting is the same as for the previous discoveries and that the 1B bbl Zhetybai field is on trend to the south-east.

Management further strengthened

JPR has recently appointed a new MD of Jupiter Energy Kazakhstan to manage the in-country operations. Mr Gamal Kulumbetov is a Kazakh national with 13 years experience in the oil and gas industry, particularly in the Mangistau region. He will be running the Aktau office for JPR and his appointment essentially completes the team required to develop the oil field in Block 31, seek new opportunities and maintain strong relationships with the relevant Kazakh authorities.

New valuation is compelling

Our valuation of JPR now stands at $2.42/share. This follows the share consolidation of 1 for 15 and the rolling forward of our NPV from 30 June 2011 to 30 June 2012.

Table 1 - JPR valuation

2012E valuation	Gross mmbbl	Net mmbbl	NPV ($m)	$/boe	$/sh
Block 31 certified reserve (2P)	24.2	24.2	234	9.65	1.96
Block 31 contingent resources (3C)	85.0	85.0	85	1.00	0.71
Total Reserves & Resources	**109.2**	**109.2**	**319**	**2.92**	**2.67**
(Net debt) / cash			14		0.12
Corporate costs			(44)		(0.37)
Equity value			**288**		
Diluted NoSh (m)			119		
Total					**2.42**

SOURCE: BELL POTTER SECURITIES ESTIMATES

We use a WACC of 12% and have (as mentioned) been conservative when it comes to the expected production per well at 450bopd. This compares with company guidance of 500bopd and the potentially higher flow rates if a 12mm choke is allowed.

A 10% higher flow rate would increase the valuation by 14% and a 10% higher oil price than our US$100 long term Brent assumption would increase the valuation by 17%.

Another fund raising planned for AIM listing

JPR has been clear about the need for additional equity funds to undertake a full field development, in the range of $30-50m. The Directors believe that the Australian market is discounting the company's Kazakh assets and plan a listing and fund raising on London's AIM market. We tend to agree with the company, as the UK market is probably a more natural "home" for the listing of JPR as a few Kazakh resource companies are listed there.

While we see the listing on AIM as a probable re-rating event for the company, the fact that the company needs to raise a significant amount of funds may hold back the share price until this is completed, probably in October-November 2011. The coming months represent very good buying opportunities in our view.

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 Jurassic sandstone but a recent test in J-52 failed to flow oil, which was disappointing.

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 enhanced its second oil well through fracking and will prepare a field development plan based on the results of the next round of drilling and testing of three wells. The reservoir is well suited to fracking 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 $2.42/share. This is based on the assumption of a 24mmbbl oil field worth $1.96/share plus resource potential of 85mmbbl currently valued at $1/bbl or $0.71/share. Cash of $14m represents $0.12/share while corporate overheads deduct $0.37/share.

An EGM held on 12 August 2011 approved a share consolidation of 1 for 15 to reduce the very large capital structure of 1.7B pieces of paper to 116m shares now on issue.

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 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 16 August 2011

Recommendation	Spec Buy
Price	$0.645
Target (12 months)	$2.42

Table 2 - 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 & cash equivalents	$m	7	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
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	116	116	116

PRODUCTION

Year ending 30 Jun	Unit	2011E	2012E	2013E	2014E
Total	mbbl	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
Underlying EPS	c/sh	(0.5)	(2.6)	1.4	12.9
EPS growth	%		467%	n.m	797%
PER	x	-140.8x	-24.8x	44.8x	5.0x
OpCFPS (ex. abnormals)	c/sh	(0.5)	(4.0)	3.2	14.5
Price/OpCFPS	x	-140.9x	-16.1x	20.0x	4.4x
DPS	c/sh	-	-	-	-
Yield	%	-	-	-	-
EV/EBITDA	x	-154.1x	9.7x	3.5x	1.6x
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 / (cash)	$m	(7)	10	20	29
ND / E	%	-14%	23%	42%	46%
ND / (ND + E)	%	-16%	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

2012E valuation	Gross mmbbl	Net mmbbl	NPV ($m)	$/boe	$/sh
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Corporate costs			(44)		(0.37)
Equity value			**288**		
Diluted NoSh (m)			119		
Total					**2.42**

VALUATION SENSITIVITIES

OIL PRICE		US$/bbl	A$m	A$/sh	% diff
	Base	97.5	288	2.42	
-10%	Low	87.8	242	2.03	-16%
+10%	High	107.3	339	2.84	17%
EXCHANGE RATE (long term)		AUD/USD	A$m	A$/sh	% diff
	Base	0.85	288	2.42	
+0.1	Low	0.95	239	2.00	-17%
-0.1	High	0.75	347	2.91	20%
WACC (post tax)		%	A$m	A$/sh	% diff
	Base	12%	288	2.42	
	Low	13%	273	2.29	-5%
	High	11%	306	2.56	6%

EPS SENSITIVITIES

OIL PRICE		2011E	2012E	2013E	2014E
US$97.5/bbl	Base	(0.5)	(2.6)	1.4	12.9
-10%	Low	(0.5)	(3.9)	(1.0)	8.1
+10%	High	(0.5)	(1.5)	3.8	17.6
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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