

January 30, 2013

JKX Oil & Gas

Increased Russian exposure to spoil 2013 financials

JKX Oil & Gas shares lost more than 20% following its 4Q12 update in which the company reported missing its production target by 20%. The full-year results disappointed in both output, which fell 15% yoy by our estimates, and operating profit, due to an increased share of low-marginal Russian natural gas in the output structure. The share of Russian-made gas (zero in 2011) reached 33% in 4Q12 and is going to increase to 60% in 2013 to cut JKX's average netback 44% yoy to USD 27 /boe. To make things worse, the company noted a lack of cash for development and tapped the market for USD 40 mln via convertible five-year notes. JKX trades on par with its Russian peers, and we see that room for both upside and downside is limited for now.

Russian assets to drive total 2013 output up 1.5x, profit down 44%

JKX plans raising output at its Russian licensed area to about 6,600 boepd by mid-2013 (up 2.5x vs. 4Q12). With no outlook on Ukraine's operations, we expect production here will further decline 25% yoy this year (average daily output, which fell 22% qoq in 4Q12, will fall 15% in FY13 compared to 4Q12). While Russian operations will drive up JKX's total output by an estimated 46% yoy in 2013, the intensified Russian activity would be not enough to cover a decline in operating profit in Ukraine. We estimate the company's gas netback was USD 1.7/Mcf in Russia in 2012, which is almost five times less than the Ukrainian operations' netback (USD 8.0/Mcf). Total netback in 2013 will fall 44% yoy, by our estimates.

USD 40 mln debt might not be enough

The company's plans suggest a total of USD 174 mln will be needed to cover its spending in 2013-14 (including USD 89 mln in CapEx and debt repayment in 2013 and another USD 85 mln in CapEx next year). Our brief analysis implies JKX (based on its outlined production targets) would generate USD 65 mln cash flow from operations in 2013. With an attracted USD 40 mln in financing, JKX will need to generate an additional USD 69 mln in cash from operations in 2014 (+6% yoy), which might be not an easy task:

- Operating costs in Russia could grow faster as JKX plans to debottleneck its gas processing capacities in Russia after reaching its gas output target in mid-2013.
- There is still uncertainty on the company's Ukrainian areas – if JKX fails to deliver promised growth in Ukrainian output since 2H13, Russian production growth might not be enough to stabilize cash flow in 2014.

Becoming increasingly Russian E&P company

With JKX's share of Russian production is going to rise to 60% in 2013, its stock should be compared to Russian oil & gas plays. The premium to Russian peers on output-based multiples no longer applies to JKX.

Looks fairly priced now

The recent share-price drop prices JKX at the lower edge of its Russian peer group, suggesting a further sell-off would not be justified. Though, given the company's recent operating underperformance and the implied risk that it may not meet 2013/14 targets, its current price does not look low either.

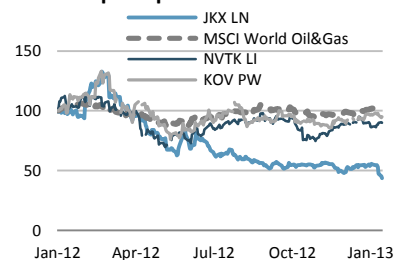
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JKX Oil & Gas

Bloomberg	JKX LN
Price, USD	0.95
No of shares, mln	171.7
Market Cap, USD mln	162.6
52-week performance	-57%
52-week range, USD	0.95/2.98
ADT, 12M, USD mln	0.4
Free float, %	47%
Free float, USD mln	76.2

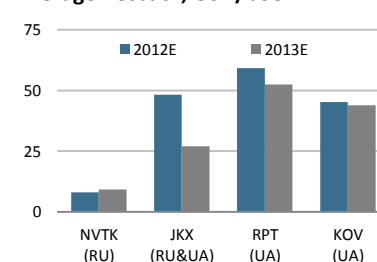
Prices as of Jan. 30, 2013

Relative price performance

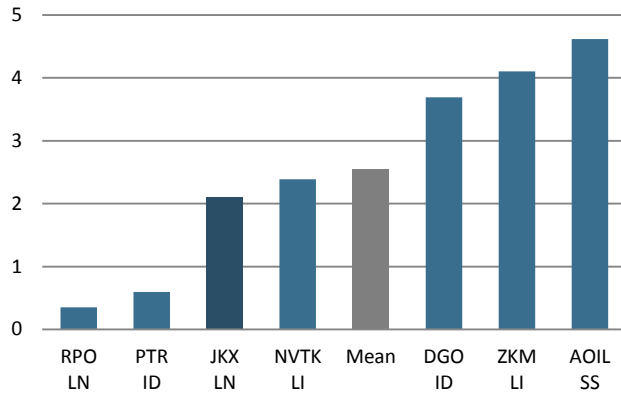


Source: Bloomberg

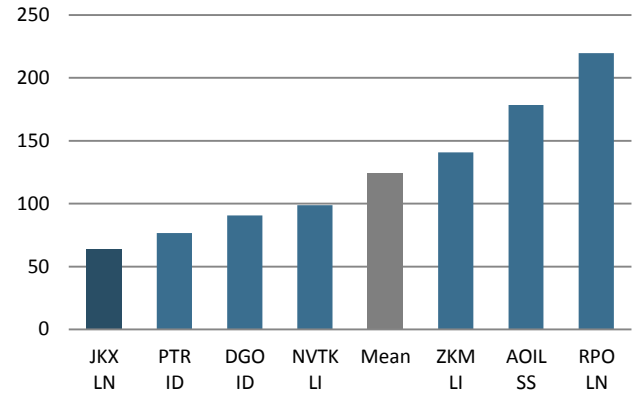
Average netback, USD/boe



Source: Company data, Concorde Capital

Peers EV/2P, USD/boe


Source: Company data, Bloomberg

Peers EV/Annual output, USD/boe


Source: Company data, Bloomberg

JKX Oil & Gas key forecasts, USD/boe (unless other specified)

	2011	1H12	2H12E	2012E	change yoy	2013E	change yoy
Production, boepd	9,045	7,481	7,929	7,706	-15%	11,315	+46%
Revenue	71.8	75.6	65.2	70.3	-2%	42.6	-39%
Production costs	5.2	5.2	5.1	5.1	-2%	5.1	-1%
Production based taxes	20.4	18.1	15.9	17.0	-17%	10.5	-38%
Netback	46.2	52.4	44.2	48.2	4%	27.0	-44%
Depreciation	9.8	18.7	17.4	18.0	83%	12.1	-33%

Source: Company data, Concorde Capital estimates

JKX Oil & Gas financials, USD mln

	2011	2012E	change yoy	2013E	change yoy
Net revenue	236.9	198.2	-16%	175.8	-11%
Production (Mboe)	3,301	2,820	-15%	4,130	46%
Operating costs	17.3	14.5	-16%	21.0	+45%
Production based taxes	67.1	47.8	-29%	43.3	-9%
Administrative & Other	38.1	29.2	-23%	32.1	+10%
EBITDA	114.4	106.7	-7%	79.4	-26%
EBITDA margin	48%	54%	+6pp.	45%	-9pp.
Net Income	59.1	39.3	-33%	24.8	-37%
Net margin	25%	20%	-5pp.	14%	-6pp.

Source: Company data, Concorde Capital estimates

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