Ukraine-focused gas exploration and production companies

Initiation of coverage

October 2, 2014

CONCORDE CAPITAL

Executive summary

We are initiating coverage of the three most liquid Ukraine-focused natural gas exploration and production companies with a single BUY recommendation (assigned to Regal Petroleum) and two SELL recommendations (assigned to Serinus Energy and JKX Oil & Gas). Our target prices are based on a sum-of-the-parts valuation, in which we estimate separately the value of the companies' operational assets (via DCF, based on the assumption of the development of their existing 2P reserves), and their cost centers, mainly their headquarters.

USD / share

	Price*	12M target
RPT LN	0.134	0.196
SEN PW	1.95	1.71
JKX LN	0.76	0.66

The core risks for the derived values of all the companies are to be found in the state regulation of the Ukraine, namely significant gas production taxes that were imposed this year for five months, with a high probability of prolongation. We've factored in a one-year prolongation in our base-case scenario (while we shouldn't rule out further extensions). We also note that if our base-case assumption becomes reality, we should expect a selloff comparable to what happened in August, with more than 20% price corrections, by this year's end.

Naturally, a possible decision of halting the high gas extraction taxes could serve as a positive catalyst for all the stocks. Among the potential positive value drivers for the companies' Ukrainian assets is a further devaluation of the Ukrainian hryvnia (ignored in our valuation models), which could increase their free cash flow, ceteris paribus, since their revenues are tied to the USD dollar and a majority of their operating and capital costs are linked to the local currency.

Our top pick from the sector is Regal Petroleum (RPT LN), which seems to have been overlooked by the market due to its poor operational performance demonstrated over the last three years. Its radical cut in its development program in Ukraine clearly does not look encouraging, while even a cut in its growth strategy can lead to value growth, providing its new well drillings will be at least as successful as past efforts. The company did a good job in cutting its corporate costs, as well as operating and capital costs per unit of production, which allows it to generate a stable cash flow. As the company is benefiting from a low subsoil tax rate in Ukraine, its value is least vulnerable to changes in tax legislation.

Our valuation suggests that JKX Oil & Gas (JKX LN) and Serinus Energy (SEN PW) do not yield any upside with the current level of their 2P reserves and corporate costs. At the same time, both companies have a reasonable potential for an upgrade in valuation and our recommendations, provided that there's success in their new exploration efforts. Their core risk for future value, as it looks right now, is the establishment of a permanent high gas production tax rate in Ukraine.

The core value growth potential for JKX is hidden in its Ukrainian Elizavetovskoye license, whose reserves might be upgraded as of end-2014. At the same time, the company has a large risk of its total 2P reserves being downgraded as soon as more information surfaces about its Rudenkovkoye field (containing 23% of its total reported 2P reserves). Its reserves at its Russian license (64% of the reported reserves) could also be downgraded due to a possible revision of its gas pricing assumptions for Russia. Some value growth potential could be unlocked if the company chooses to cut its U.K. costs, which could happen in the event of a change in its ownership structure, following Regal's example.

Serinus's value growth depends more on the success of its new international projects, with Romania being the most obvious opportunity. Some minor hopes could be pinned to its Brunei project, where the company has spent more than USD 300 mln over the last five years. No downside surprises are visible that could be related to Serinus's reserves (unlike JKX), as the company seems to have fairly estimated its prospects in all its projects.

** Closing price as of Oct. 1 , 2014*
Source: Bloomberg, Concorde Capital research

Content

Overview of Ukrainian gas sector

Natural gas in Ukraine

Natural gas accounts for more than one-third of primary energy sources consumed in Ukraine.

Gas production on Ukraine's territory peaked in 1975 at 68 bcm after the discovery of gas-rich deposits in the Dnipro-Donets reserve, while the production was steadily decreasing owing to the depletion of its easily extractable reserves. Over the last decade, gas production has ranged between 18 bcm and 21 bcm p.a. in Ukraine.

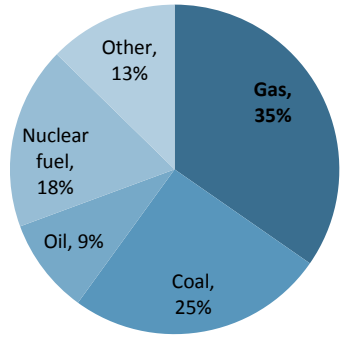
Ukraine's Energy Strategy till 2030 does not project a significant increase in production of conventional on-shore natural gas: even under an optimistic scenario, gas production in 2030 is assumed at 24 bcm p.a. (0.7% CAGR).

The subsidiaries of state holding Naftogaz of Ukraine accounted for 87% of total domestic natural gas production in 2013, with the Crimea-based state subsidiary (which is currently not controlled by the Ukrainian government) accounting for 6% of natural gas production. Due to the low sales tariffs for state-run gas producers (which do not cover even production costs), Naftogaz subsidiaries have not demonstrated any increase in gas output over the last decade (-0.1% CAGR). At the same time, increasingly more private gas producers have appeared in Ukraine, which either buy gas licenses from the state or rent gas production facilities from state-run companies. Gas production by private companies has accelerated 2.3x in the last decade.

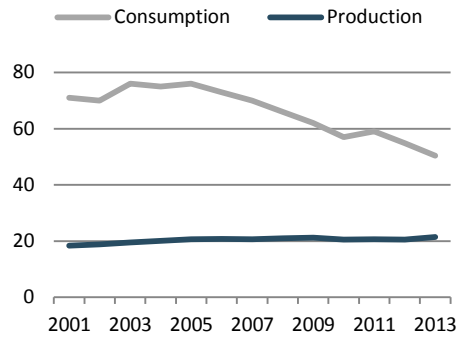
Gas consumption in Ukraine has declined at a 3.8% CAGR over the last decade, though it still exceeds domestic production by nearly 2.5x times. Ukraine's total gas import bill is close to USD 11 bln p.a. over the last couple of years.

Gas imports have been steadily declining in line with the decrease of the gap between internal production and consumption. Once having diverse sources of imported gas, over the last five years Ukraine has imported gas primarily from Russia. However, in light of the recent war, Ukraine's government plans to minimize direct gas imports from Russia, reverting to EU sources instead. Ironically, they offer the same Russian gas at a lower price. Currently, the maximum reimporting capacity from the EU is close to 15 bcm p.a., while the need for gas imports is not less than 24 bcm p.a.

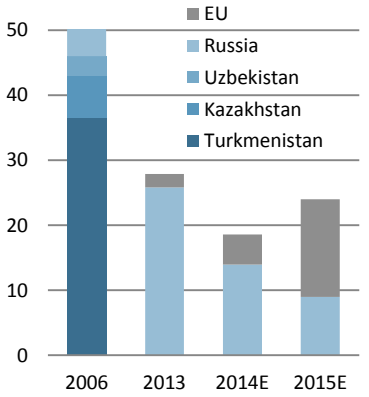
Primary energy use in Ukraine, 2010



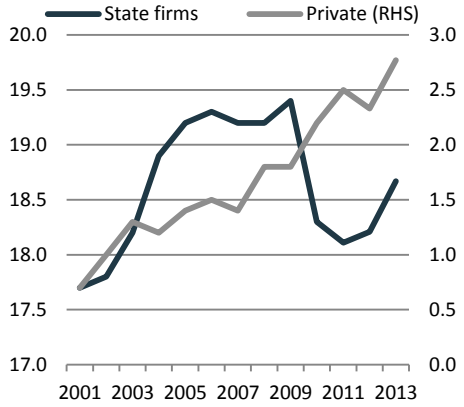
Gas stats in Ukraine, bcm



Sources of gas imports, bcm



Gas production in Ukraine, bcm



Source: Energy Ministry, Energobiznes, Naftogaz , Concorde Capital forecasts

Resource base for natural gas

Natural gas deposits

Ukraine's total onshore extractable gas reserves are estimated at 1,094 bcm (which would take about 60 years to extract, at current levels) and total resources are estimated at 4,292 bcm, as of 2011.

Total offshore gas reserves are estimated at 48 bcm and total resources are estimated at 1,751 bcm, as of 2011.

Three oil and gas bearing provinces are differentiated in Ukraine, with almost 90% of total gas produced in the northeastern regions (Dnipro-Donets reserve). All three of our covered gas production companies are operating in this region of Ukraine.

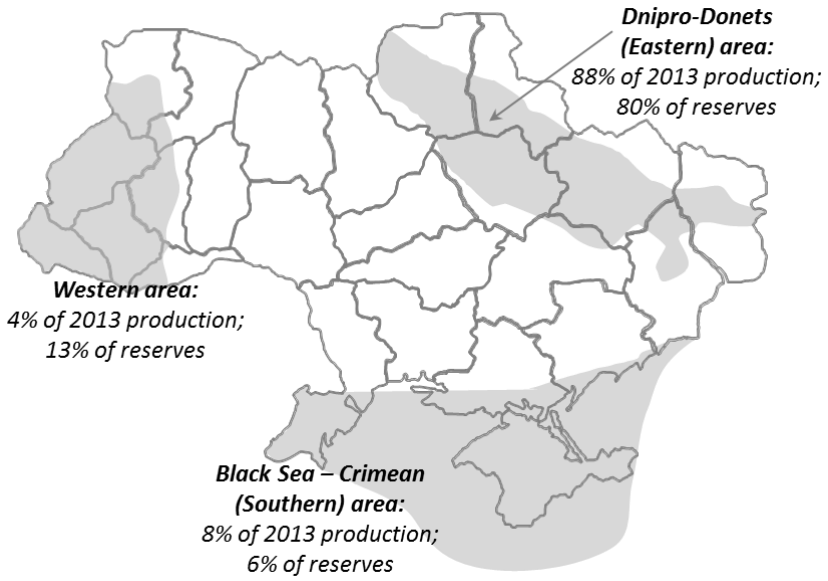
The western regions are considered to be depleted (hydrocarbon production started there in 1853) and it's more concentrated on oil production.

The southern region is mostly rich in offshore gas deposits and is the least developed. With occupation of Crimea by Russia in March, Ukraine has lost its subsidiary Chornomornaftogaz, which operated in the Crimean peninsula as well as developed offshore oil and gas deposits, including those located farther from Crimea than from the other territory of Ukraine. The subsidiary produced 0.34 bcm of gas in 2M14, or 9% of Ukraine's total.

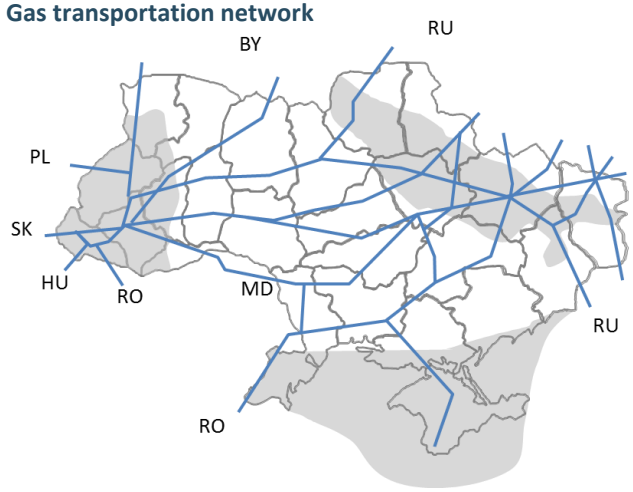
Gas transit system

As a gas transporting country, Ukraine has a well-developed network of gas pipelines that cross over all its gas-bearing locations. The network of local distribution pipelines is even more intense. The proximity of pipelines to all the gas-rich reserves enables savings in the capital costs of new private gas producers.

Oil & gas reserves in Ukraine



Gas transportation network



Source: Energy Ministry, Naftogaz, mass media

Gas balance in Ukraine: too long a way to self-sufficiency

Low residential gas rates prevent further gas use cuts

The Ukrainian industrial sector managed to decrease gas consumption by 46% over the last decade, with the metallurgical industry being the leader in improved efficiency. At the same time, households decreased their gas consumption just 9% during the decade, while per capital consumption fell only 4% during the period.

Low, regulated gas prices for residential consumers did not stimulate any energy saving efforts. The government has not rushed to increase residential gas rates to economically justified levels, which leads us to expect that it will take several decades for the gas market to balance out in Ukraine.

Interestingly, an Energy Strategy of Ukraine designed by the respective ministry just a year ago assumes that Ukraine's gas consumption will be 49 bcm in 2030 (and 47 bcm the in low-case scenario) . Yet the current war with key gas supplier Russia has led the government to meet this 15-year target already this year.

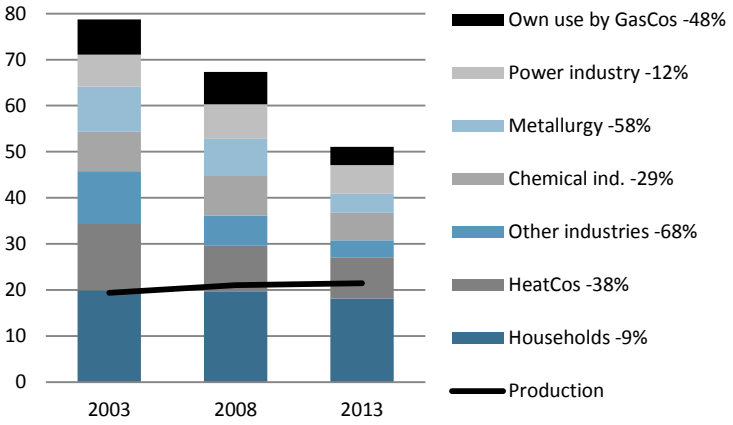
In its base-case, the Energy Strategy assumes that total gas production in Ukraine will reach 44 bcm by 2030, with 24 bcm being unconventional natural gas (shale gas, methane from coal deposits, gas extracted from deep offshore deposits).

Seasonality of gas consumption points to huge gas savings potential

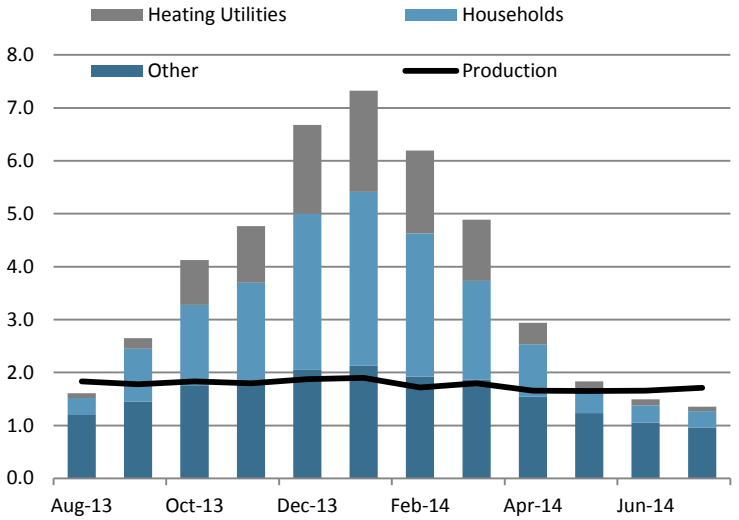
The vast majority of Ukrainian gas is consumed to produce heat, as can be concluded from the chart below. There was a 5.4x difference between gas consumption in January and July. In the summer months, Ukraine consumes less gas than it produces.

Such phenomena point to a huge potential for declines in gas consumption, providing Ukraine will implement actively simple energy-saving measures that will enable conserving more heat indoors and reducing the transit losses of heat by central heating utilities.

Annual gas consumption and production, bcm (chg vs. 2003)



Monthly gas consumption and production in Ukraine, bcm



Source: UkrStat, Energobiznes, Concorde Capital research

Gas imports: seeking alternatives to Russia

Imports from EU as pressure on Gazprom in 2013

Ukraine started importing natural gas from the EU in late 2012 to gain some bargaining power in its talks on gas pricing with Russia. Ironically, the state was able to buy the same Russian gas that was pumped though Ukraine to the West, importing it back into the country. It's logical that direct gas supplies from Russia should be priced lower, under a free market, but Russian foreign policy goals have undermined that basic principle.

In December 2013, the Russian and Ukrainian presidents agreed to a new "special gas price" for Ukraine at USD 268.5/tcm which, as it's clear now, was the payment for not signing the Association Agreement with the EU, as was scheduled for November 2013. With such a discount from Russia, Ukraine stopped importing natural gas from the EU at the beginning of 2014. Though, the discount was short-lived (the deal's validity was to have been confirmed by Russia each quarter).

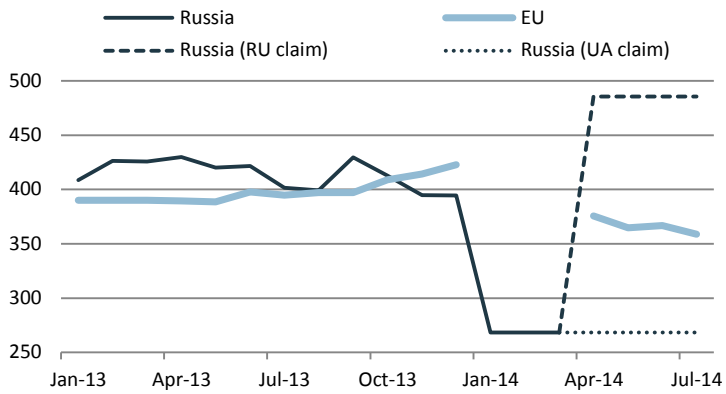
EU import as necessity in 2014

Ukraine's post-EuroMaidan war with Russia directly affected economic arrangements. Gazprom returned to discount-free pricing, charging USD 485.5/tcm for its gas since April 2014. Ukraine refused to pay such a price, claiming that 268.5/tcm rate was the market rate. Though Russia came back with a new "discounted price" of USD 385.5/tcm, the Ukrainian side decided not to accept it, banking on the potential for a bigger discount. Ukraine has stopped importing Russian gas since June 16. In that time, Ukraine has accumulated payables for 11.5 bcm of natural gas earlier imported from Russia worth USD 3.58-5.30 bln (depending on what price is settled upon). Now Ukraine is trying to renegotiate with Russia and, as of late, has reached an interim agreement to buy gas for USD 385/tcm this winter season.

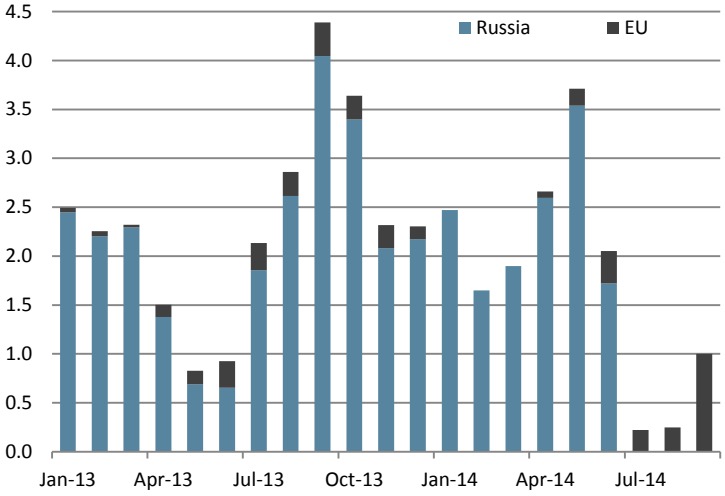
Ukraine's attempts to diversify gas imports paid off – the average gas import price decreased in 2013 and 2014, as compared to the price stipulated by a ten-year contract signed with Gazprom in 2009.

For forecasting purposes, we assume the price of imported gas will be stable at about USD 390/tm (which serves as a benchmark for setting domestic gas prices for independent producers), though we admit that there is a downside risk for the short term and upside risk for the mid term.

Average Ukraine's import price by source, USD/tcm



Monthly gas import by source, bcm



Source: UkrStat, Ministry of Economy, Interfax, Concorde Capital research

Gas pricing in Ukraine: beneficial for private producers

State gas producers obliged to supply all their gas to privileged consumers

The Ukrainian government is subsidizing gas consumption by heating utilities and households. They currently pay only UAH 1,309 (about USD 100) per tcm of gas. This price is also deducted for transit and distribution costs and other charges. State-run gas producers are required to sell gas to subsidized consumers. The net price they receive for extracted gas is UAH 349/tcm (USD 26/tcm). Since household consumption exceeds the own gas production of state-controlled companies, Naftogaz has to supply some portion of expensive, imported gas to them.

The unattractive price for state-produced gas is the key factor that discourages state holdings from developing new gas fields. Private producers benefit because state companies end up selling them gas fields whose development is not economically justified at the regulated prices. For private producers, which may secure up to 14x higher gas prices than state holdings, the development of such fields looks rather lucrative.

Industrial consumers are buying gas which either comes from abroad or is supplied by private producers.

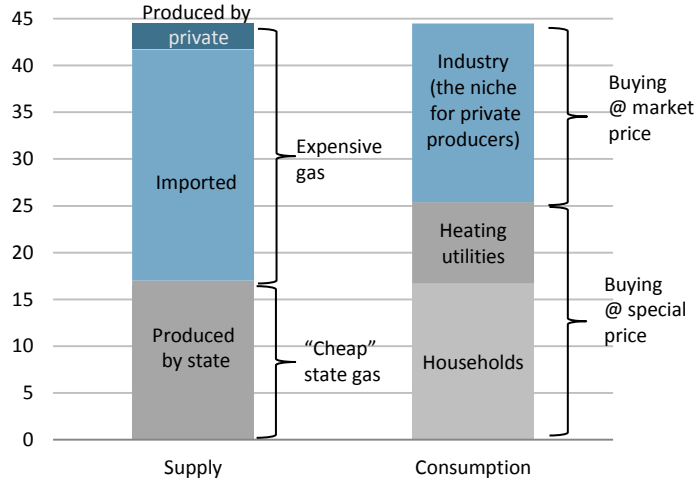
Price benchmark for private producers: *marginal price*

The price of gas supplied to industrial consumers is capped by the state regulator, which assigns a ***marginal price*** **(currently UAH 4,874/tcm, or USD 364/tcm).** The marginal price is the net price that private producers can potentially receive from their consumers (who pay for transit and supply in addition to the gas itself).

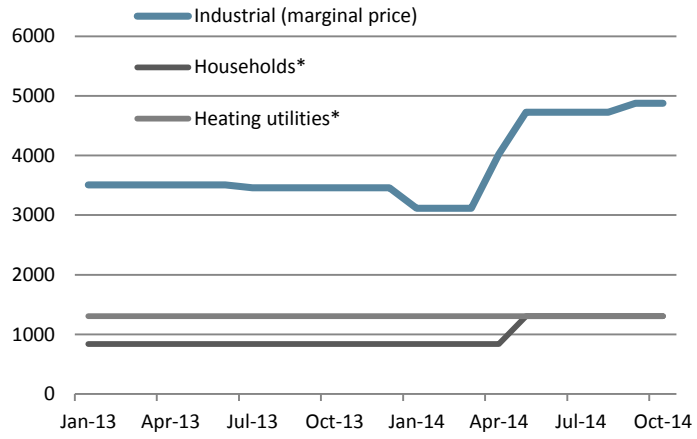
In its essence, the marginal price is the net price which Naftogaz subsidiaries charge from their industrial consumers. **Private producers** of gas are price takers on the market. Usually, they have to **sell their gas** to traders or industrial consumers at **an agreed-upon discount to the marginal price**. For the discounts achieved by particular producers, refer to page 17.

The marginal gas price in Ukraine does not account for its calorific value – all the gas that meets the minimum industry standards is priced equally. This allows independent gas producers that extract "fat" gas to separate LPG and gain additional profits with nearly unchanged volumes of sellable gas available to them.

Sourcing and use of natural gas in Ukraine in 2013, bcm



Gas prices in Ukraine by consumer type, UAH/tcm



** The final price for consumers, which includes distribution and supply costs*
Source: NERC, Energobiznes, Concorde Capital calculations

Gas price for private producers is linked to USD-based import price

Marginal price setting

The marginal price is designed by the state regulator to allow for **covering the cost of natural gas imports** and allow for some profit to partially subsidize the costs of gas supply to preferential consumers. It is set based on the regulator's view of the future import gas price and is revised once the assumptions on import price change.

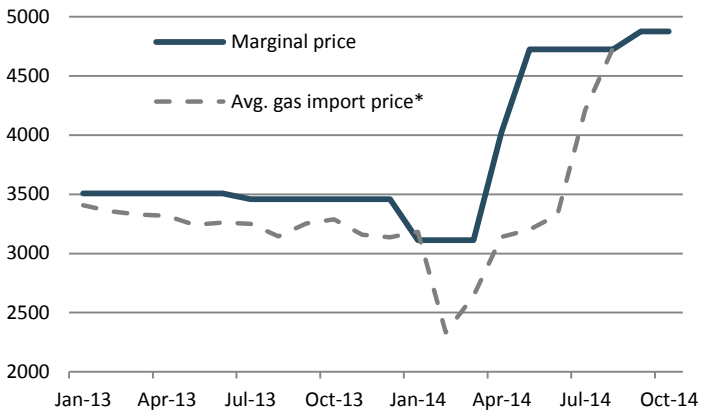
The core feature of the marginal price in Ukraine is its linkage to the U.S. dollar, although with some lag, which is needed for adjusting to the market if the UAH/USD exchange rate volatility is high (as it has been recently). **Devaluation of local currency**, therefore, **is beneficial for local private gas producers**, as most of their operating and capital costs are linked to the local currency.

Recent changes in the marginal price

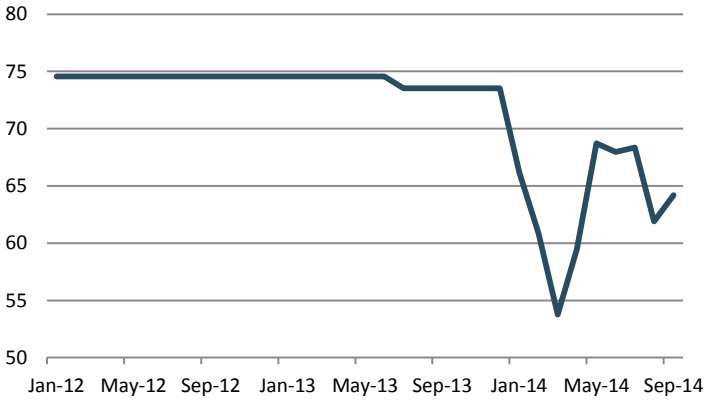
After Russia agreed to reduce its gas price as of January 2014, the state regulator decreased the marginal price by 10% for 1Q14. The price has risen since 2Q14, after Russia dropped its discount and the Ukrainian currency started devaluing.

For the future periods, we expect the marginal price will be around a level of USD 11.5/tcf (USD 406/tcm or USD 69/boe of gas).

Marginal price and import price, UAH/tcm



Marginal price, USD/boe*



** Based on average official (NBU) exchange rate*

Source: NERC, Economy Ministry, Energobiznes, Interfax, Concorde Capital calculations

Production tax for private gas producers: a temporary hike?

Each unit of extracted natural gas by private producers is subject to a single royalty (production-based) tax.

The production tax rate depends on the depth of the gas deposit and the duration of well commissioning. The following tax rates are currently applied:

- Standard tax rate for natural gas (currently 55%, may decline to 28% as of 2015)
- Tax rate for reservoirs deeper than 5,000m (currently 28%, may decline to 15% as of 2015). This tax is applicable to Regal Petroleum.
- For the wells that are commissioned after Aug. 1, 2014, a special 0.55x multiplier is applied to the tax rate for the well's first two years of production. This innovation was introduced in August.

Recent changes in production tax rate

As private gas production is considered an exceptionally profitable business (due to high reported operating margins), the government initiated a series of revisions of tax rates this year to earn more budget proceeds. Since April 2014, standard tax rates increased to 28% from 25% (the deep well rate was increased to 15% from 14%). Since the state budget needed even more revenue in the second half, emergency legislation was adopted to temporarily hike the standard tax rate to 55% (deep rate to 28%) for Aug.-Dec. 2014.

The base for applying the tax was the price of imported natural gas, for a long time until this year. This price was calculated each month by the Economy Ministry. Since the price of imported gas fell radically in January 2014 (with Russia granting a valuable discount for Ukraine), the tax base fell sharply in 1Q14. Even after Russia cancelled its special price in April, Ukraine continued to assume unilaterally it was buying Russian gas at USD 268.5/tcm in April-June. This artificially prolonged the low taxation base of private gas producers for three more months. Understanding its "mistake", the government changed the base of taxation as of August 2014. **Now the tax rate is applied to the marginal gas price.**

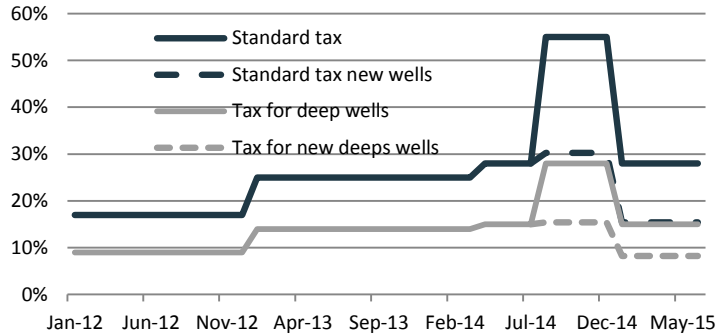
The change of the taxation base and interim increase of tax rate since August 2014 will result in an increase of the total production-based tax per unit of privately produced gas by 40% in 2H14, compared to 1H14, in USD terms.

Will the high-tax initiative be prolonged for the future?

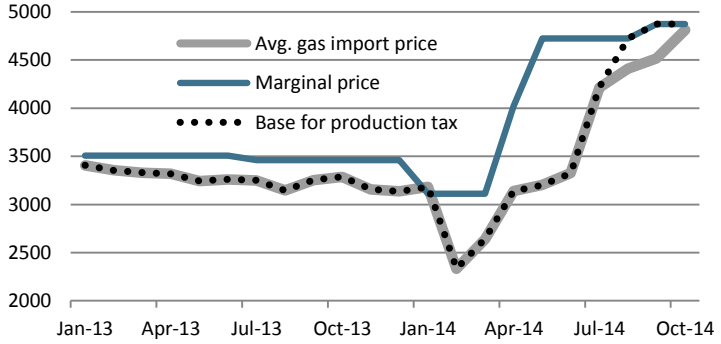
Despite the current legislation stipulating that tax rates will fall back to 28% (15% deep rate) as of January 2015, the Finance Ministry clearly has the temptation to preserve these rates for future periods. Keeping rates at the Aug. 2014 levels next year will allow the Ukrainian budget to gain an additional USD 280 mln in 2015. Such revenue growth prospects might be a bigger priority now for the government compared to not wanting to suppress the gas industry or producing more gas internally.

In our base-case scenario, we assume the interim high tax rate will be prolonged for one more year and will return to the level of 28% (15%) since 2016. **At the same time, we do not rule out that the high rates will become permanent – such a deviation from our base-case scenario has been also properly modeled.** As we show below, the value of some covered gas producers is very sensitive to changes in tax assumptions.

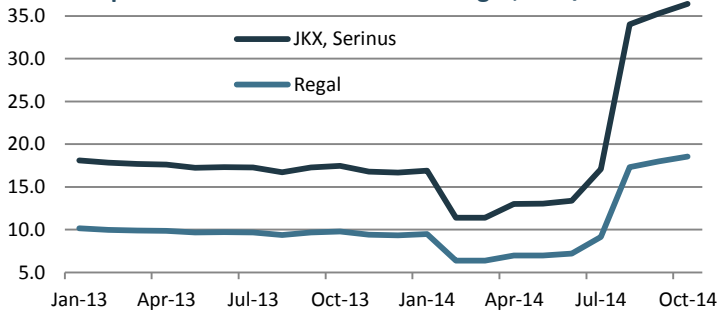
Rate of gas production tax for private producers



Taxation base for gas for private producers, UAH/tcm



Effective production-based tax for natural gas, USD/boe



Source: Parliament, NBU, Economy Ministry, Interfax, Concorde Capital forecasts

Private gas production: business for the select

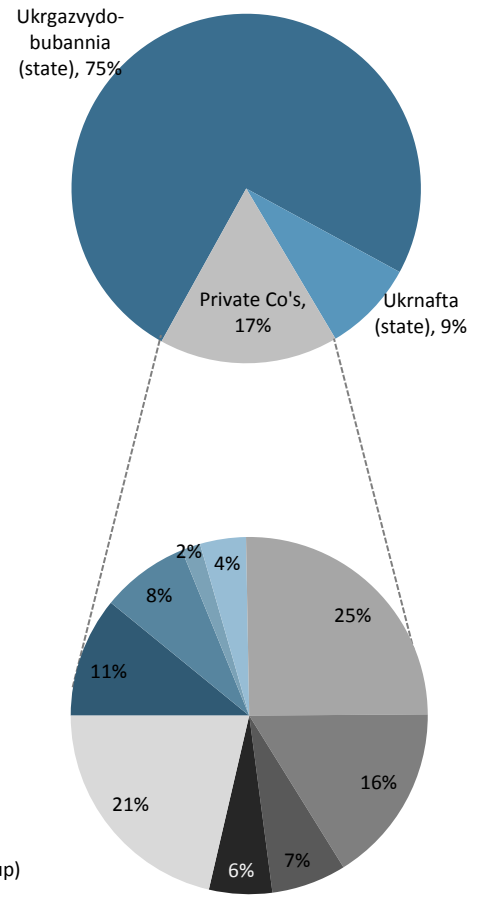
About 40 private gas producers are currently operating in Ukraine, which belong to either the local business elite or international gas companies. Aggregately, they account for just 17% of natural gas production in Ukraine.

The high profitability of private gas production in Ukraine makes this business hard to enter for the outsiders. Most of the gas production companies operating in Ukraine have ties to oligarchs, or are acting/former officials responsible for regulating the sector or in local government. Poor property protection rights in Ukraine create a high risk of being targeted for hostile takeover, and the typically tough licensing rules create vulnerability to asset loss. The presence of powerful partners is vital for cloudless gas drilling operations in Ukraine.

The experience of Regal is very illustrative – the company was granted a license for developing hard-to-reach reserves (at a depth of more than 5,000 m). But as soon as it gained success in reserves development in early 2010, its license had been suspended later in the year. The company solved its licensing issues only after the entrance of a Ukrainian tycoon into its equity.

The assets of JKX and Serinus Energy seem to be exclusions to the rule, while the Ukrainian subsidiary of the latter seems to have links with local elites in the Donbas region.

Share of gas production in Ukraine in August 2014



Notably, all of the top five wealthiest in the Ukrainian list of Forbes magazine (as well as the holder of the top position in the Polish rating, Jan Kulczyk) are among the owners of junior gas production companies in Ukraine.

Their considerable influence on Ukraine's economy and politics, creates the possibility that high gas production taxes will not be set for an indefinite period of time.

Forbes rankings of wealthiest Ukrainians

Name	Group	2013	2014
R. Akhmetov	SCM	1	1
V. Pinchuk	EastOne	2	2
I.Kolomoisky	Privat	4	3
G.Bogolyubov	Privat	3	5
V.Novinsky	Smart	5	4

Biggest private gas producers:

- KUB-Gaz (Serinus)
- Poltava Gas & Oil Company (JKX)
- Regal (Smart group)
- Ukrgazvydobutok & Prom-Energo (Smart group)
- Naftogazvydobuvannia (SCM group)
- Esko-Pivnich (ex Environment Minister)
- Pryrodni Resursy (Geo Alliance, EastOne group)
- Ukrnaftoburinnia (ex. Energy Minister vs. Privat group)
- Other

Source: Energobiznes, Forbes, mass media, Concorde Capital research

JKX, Regal and Serinus: company comparison

JKX, Regal, Serinus in nutshell

The three covered oil & gas exploration and production (E&P) companies are international holdings with the focus of their operations on Ukraine. All of them are focused on the gas production in Ukraine, while JKX and Regal also are producing valuable byproducts like condensate and LPG.

Since debt financing is barely available for E&P companies due their risks, they tapped equity markets with initial public offerings:

- Regal and JKX have been listed on the London Stock Exchange for more than a decade
- Serinus entered the Warsaw Stock Exchange in 2013 and gained a listing in Toronto in 2013

In the recent years, JKX and Serinus were able to attract debt financing via issue of convertible bonds, which Serinus had converted into equity in 2013. Serinus also attracted some funds to finance its Ukrainian and Tunisian operations from EBRD. Regal's leverage remains zero, as of today.

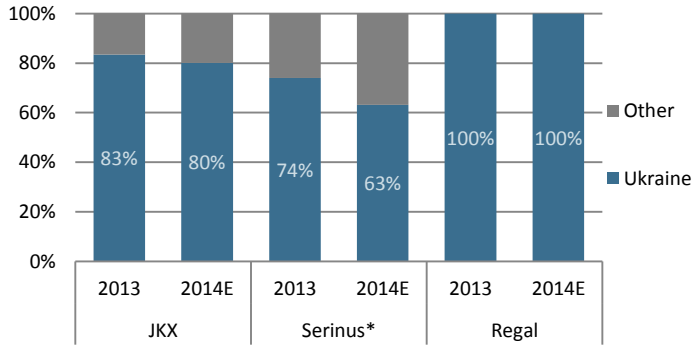
While most of their current revenue comes from Ukrainian assets, JKX and Serinus are developing international operations posting high 2P reserves outside Ukraine

- JKX started producing natural gas in Russia in 2012
- Serinus started extracting oil in Tunisia in 2013 after a merger with Winstar Resources
- Regal focuses solely on Ukraine, having divested all its other licenses.

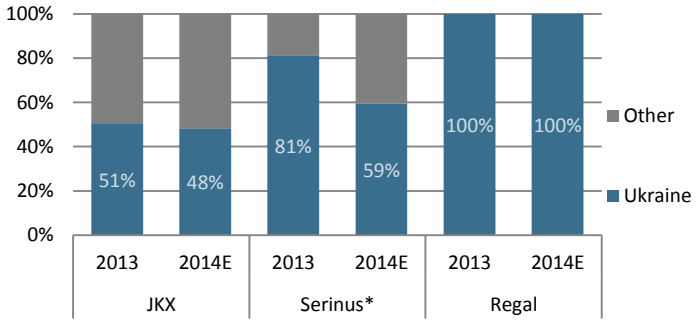
- JKX and Regal fully own their Ukraine-based assets and control their operations.
- Serinus Energy owns only 70% of its Ukrainian asset, KUB-Gaz. The remaining 30% is controlled by Toronto-listed CUB-Energy, whose managers claim to have operating control over the asset. Serinus, therefore, is considered to be a portfolio investor in KUB-Gaz. It shares all the costs and profit of KUB-Gaz with the other shareholder on a pro rata basis.

- JKX has no majority shareholder, while
- Serinus Energy is controlled by Polish tycoon Jan Kulczyk and
- Regal is controlled by Ukrainian tycoon Vadim Novinsky

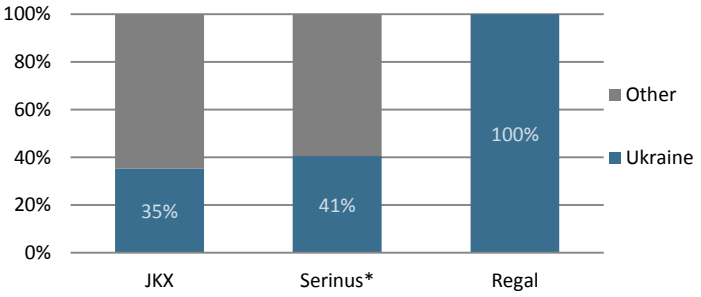
Revenue breakdown by regions



Hydrocarbon output breakdown, in boe



2P reserves breakdown, in boe



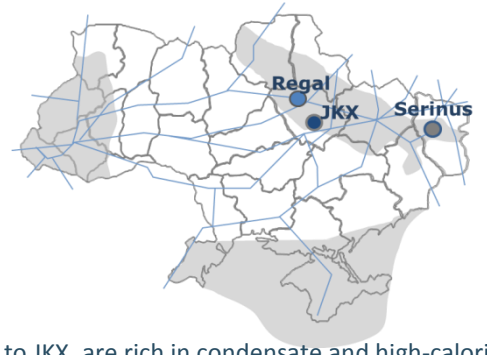
Source: Company data, Concorde Capital forecasts
** For Serinus – net numbers (based on its working interest)*

Ukrainian deposits

The three companies are developing gas and condensate fields in the Eastern gas reserve in Ukraine. They are operating on licensed areas that don't interest state-run gas producers due to:

- their depleted resources (legacy deposits produce too little gas to be economically justifiable to operate for state companies, but large enough to sell at a market price and a solid profit);
- difficult mining conditions (high depth of deposits)
- their reserves having been poorly studied.

Having benefited from exceptionally high domestic gas prices, especially when compared to those of state-run producers, these companies enjoy a high rate of return on their investments into Ukrainian deposits. On the flip side, they bear high risks of geological failure.



Hydrocarbon mix

The deposits of Regal, and some belonging to JKX, are rich in condensate and high-calorific gas additions, which enables them to gain additional revenue from selling byproducts – condensate and LPG.

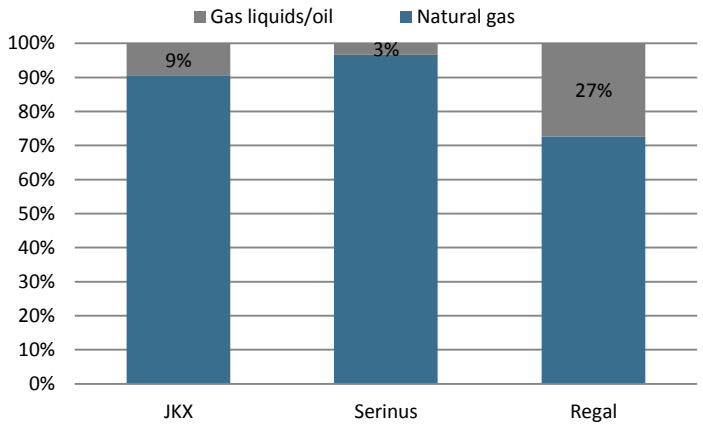
Serinus's deposits contain less calorific gas and little condensate.

Depth and drilling costs

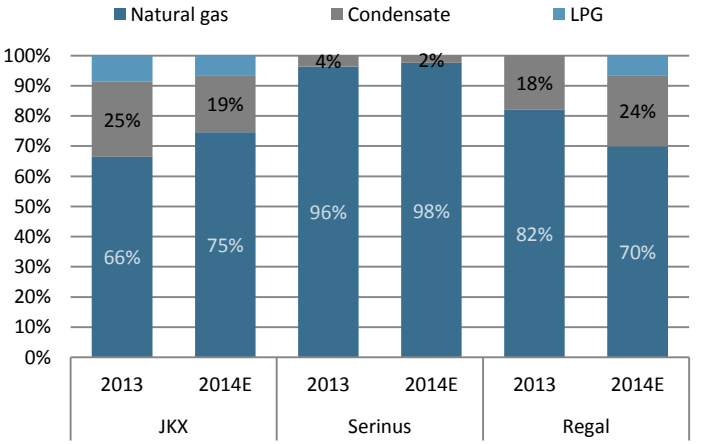
Regal is developing the deepest gas reserve of the three companies (TD of the wells drilled in the last two years range between 5,200-5,500 m) and has the highest well-drilling costs (about USD 11-12 mln per well, we estimate). Yet it also benefits from the lowest production tax rate (45%-50% lower vs. its peers) and the lowest rate of gas yield decline of its wells.

The deposits of other covered companies are shallower in Ukraine: 1,800-3,200 m for JKX and 2,200m-4,300m for Serinus. JKX reports the average cost of its well drilling at about USD 3.1 mln (as of 2012), while Serinus estimated its well costs at USD 2.0 mln in 2014 (gross).

Ukraine's 2P reserves breakdown, in boe



Breakdown of Ukraine's hydrocarbon sales, boe



Source: Company data, Concorde Capital forecasts

Expenditures and return of gas fields

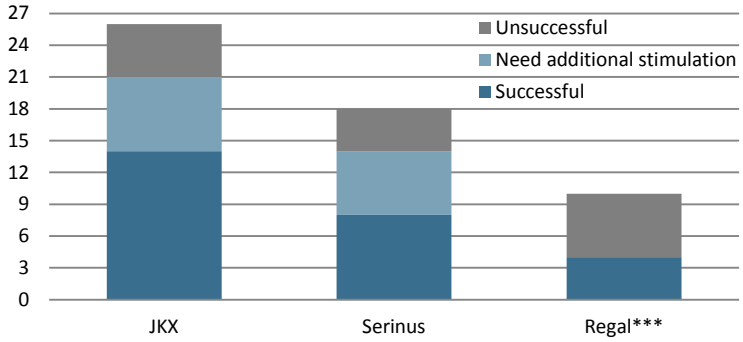
The three companies differ much in terms of their capital intensity and success rate of their fields development, as can be concluded based on the charts on the right:

Serinus's project looks the most successful in Ukraine, as it enjoys a stable production growth path with the smallest capital expenditures. Its Ukrainian deposits are relatively shallow, enabling it to enjoy the lowest drilling costs among its peers. Unlike its peers, Serinus's deposits contain little condensate, which makes its average price per boe of hydrocarbons produced the smallest. However, this does not prevent the company from showing operating profit per boe sold that is comparable to its peers, mainly because its Ukrainian subsidiary reports little overhead costs.

Regal is the other extreme to Serinus – it's struggling to increase its production and keep its capital costs under control. Due to the high depths of its reserves, Regal's costs to drill new wells are 3-4 times higher than for peers, which don't allow it to drill as much as its competitors do. Limited drilling program has is coupled with low success rate – just one of three wells drilled since 2011 has been successful. Such results led to Regal's gradual decline in production over the last three years. An encouraging feature of the company's reserve is the low rate of wells' yield decline (about 10% p.a. vs. peers' 20%-30% p.a., we estimate), which indicates it can extract much more resources from a single well.

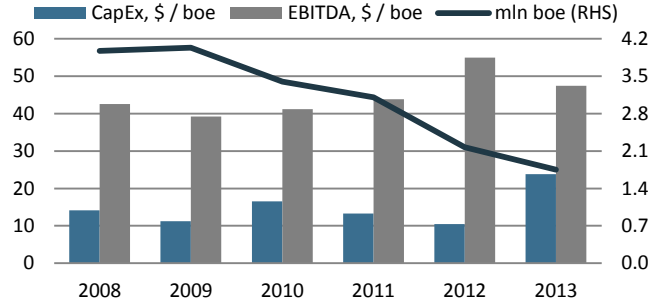
JKX Oil & Gas has shown the lowest level of investment into its Ukrainian assets, as well as the deepest decline in production over the last four years. However in 2013, it intensified the development of its Ukrainian fields to be able to increase its production as of early 2014. The company also enjoys the highest average price and profit per boe of sold hydrocarbons, thanks to the most valuable output mix.

Well drilling results in Ukraine, 2010-1H14

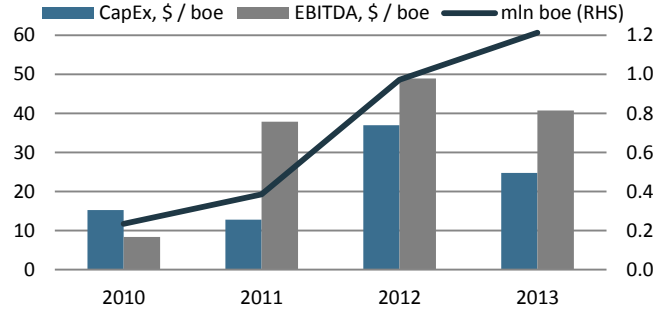


Investments, production and profit in Ukraine

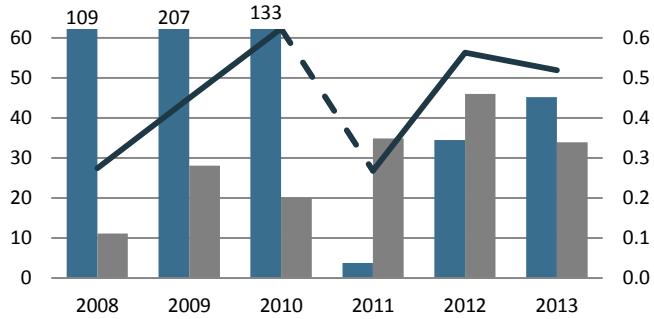
JKX



Serinus*



Regal**



** For Serinus – gross numbers; **Regal did not operate between Dec. '10 – July '11 as its licenses were suspended. Regal's EBITDA does not account for the cost of written off inventories in 2011-2013. *** For Regal – wells data for 2009-1H14. Source: Company data, Concorde Capital estimates*

Ukrainian operations

Production trends

Of the three companies, **Regal** has failed to provide any output growth in Ukraine since 2011, which is a result of poor luck with its recent wells development – only one well of the three recently drilled has been successful. Yet an encouraging feature of Regal is its relatively low output decline rate.

Serinus is more lucky in terms of new and worked-over wells completion as it has shown output growth since entering Ukraine. The yield decline rate at Serinus's existing wells is bigger than for Regal, at about 20%-25%, as the company's resource report indicates.

JKX Oil & Gas overlooked its Ukrainian operations as it has refocused on the development of its Russian assets since 2010. With the restart of intensive drilling operations in 2013 and the success of its newly developing Elizavetovskoye field, it managed to improve its production in Ukraine in 2014. The decline rate of JKX's Ukrainian wells is higher than for peers, at about 30%, as their history suggests.

Gas pricing

The selling prices of natural gas by the covered companies do not differ much: the historical levels of discounts to the marginal price on the market range between 2% and 7%, with JKX being more successful in its pricing efforts and Serinus usually lagging.

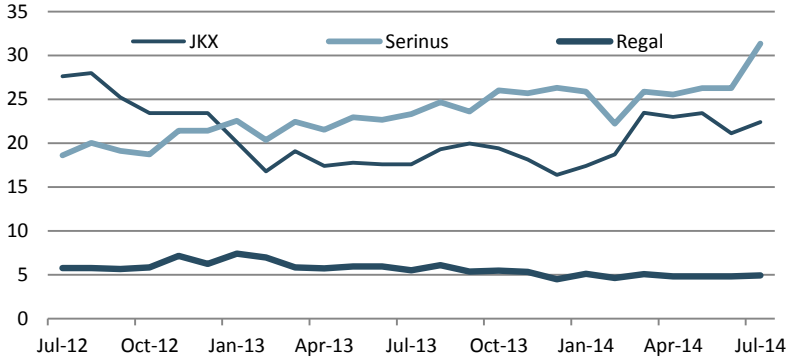
Byproduct sales and average hydrocarbon prices

Nearly 98% of **Serinus's** total sales in Ukraine come from natural gas, while a significant portion of the sales of **Regal** and **JKX** are the condensate and LPG byproducts. For this reason, Regal and JKX enjoy better average price per boe of hydrocarbons sold, in comparison to **Serinus**.

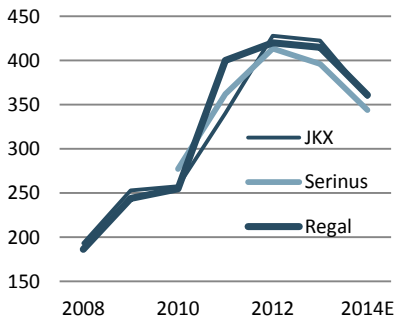
JKX recently succeeded in developing a new field that is poor in condensate, implying its average revenue per boe will slightly decrease in the future. However, this will be offset by the lower royalty rate that JKX will pay from its new wells (commissioned after Aug. 1, 2014), provided that the upcoming wells at the new field will be as successful as the first two.

Taking a different approach, **Regal** commissioned its upgraded gas processing facility to initiate LPG production and increase condensate output as of 1H14. For this reason, Regal will demonstrate the best average price change for its products in 2014.

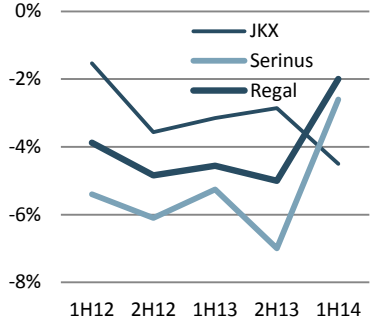
Monthly gas production, mcm



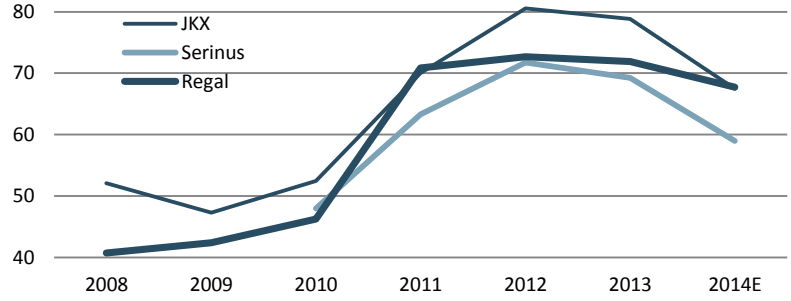
Gas selling price, USD/tcm



Discount to marginal price



Average price per boe sold, USD



Source: Company data, Energobiznes, Concorde Capital forecasts

Exact location in Ukraine matters now as never before

The war in Ukraine's eastern regions has frightened some investors from all their Ukrainian assets, including gas E&P companies. Clearly, warfare is a high risk in and of itself, though among the three covered companies some degree of political risk is inherent to Serinus Energy only. So far, military activity is occurring only in a part of the two easternmost regions of Donetsk and Luhansk.

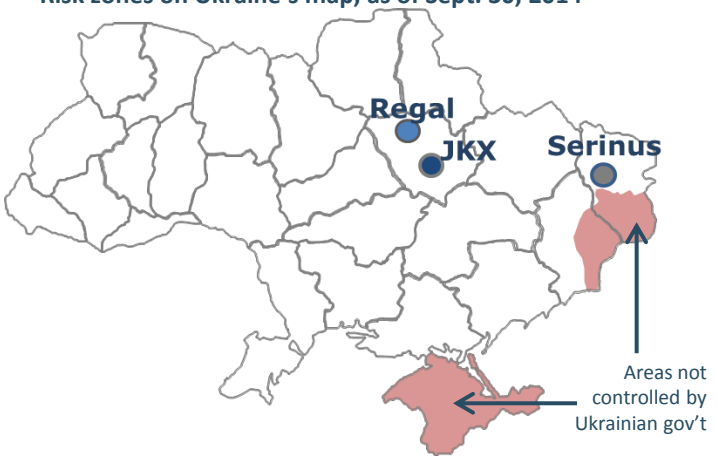
The gas fields of Regal and JKX are located in the Poltava region, the core gas-producing region of Ukraine (responsible for the output of 1/3 of Ukraine's total gas). They are located 300 km from the nearest military activity.

The location of Serinus's assets in the Luhansk region, a portion of which has been plagued by warfare, **is its core risk right now**. Though looking more closely at the map, we've concluded that a real threat is posed for only two licenses of KUB-Gaz, which are depleted and produce little gas:

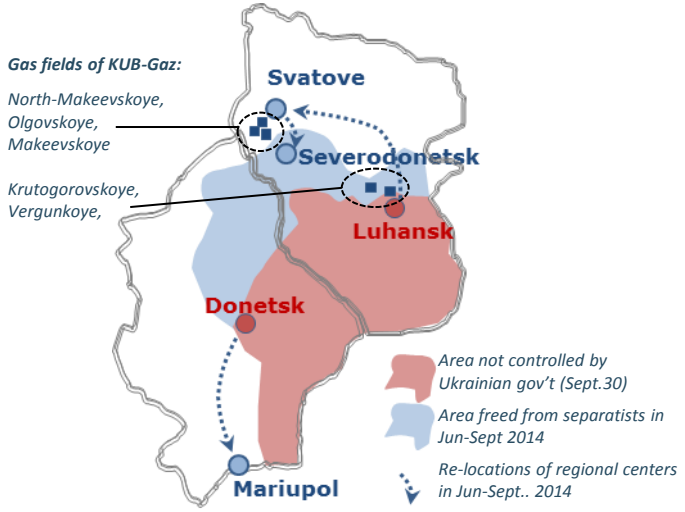
- **Vergunskoye and Krutogorovskoye** are located within 10 km of the city of Luhansk, which is in the self-governing zones. Although Ukrainian officials claim they control that area, the exact situation there is neither clear nor predictable. The good news is that:
  - their combined proven and 2P reserves account for **3.7% and 3.8% of KUB-Gaz's total**;
  - their combined gas output in 1Q14 (when the region was totally safe) accounted for **2.9% of KUB-Gaz's total.**
- **Three other KUB-Gaz fields are located on territory that was never occupied by the separatists.** They are currently located about 60 km away from the self-governing zones. The relative safety of their location can be illustrated by the fact that headquarters of the Luhansk State Administration (the Presidential Administration's rep. office) moved in August from the town of Svatove to Severodonetsk, a city located closer to the self-governing zone than KUB-Gaz's main assets.

Nonetheless, due to the risks for KUB-Gaz personnel and assets, the company stopped all its field development operations in June 2014. It's planning to restart drilling operations (in its safest zone) in October, according to its last update in August. Provided there is no new escalation by Russian forces in the region, the company will likely move forward with this plan, which will mean the postponement of commissioning new wells by about half a year compared to its pre-crisis plan.

Risk zones on Ukraine's map, as of Sept. 30, 2014



Risk zones on the map of Donetsk and Luhansk regions



Source: Company data, National Security and Defense Council, Concorde Capital research

Ukraine is cash-cow, abroad assets are mostly cost centers

All other regions funded by Ukraine's cash flows

The beneficial regulatory and pricing environment in Ukraine's gas sector has enabled the covered companies to generate large cash flow. Over the last three years, the Ukrainian operations of the E&P companies served as cash cows that supported their international head offices and generated cash flows for reinvestment into other international opportunities.

Thus far, only Serinus Energy has managed to find an efficient project outside of Ukraine. Regal stopped its attempts to look for overseas projects, while JKX is trying to make its new Russian assets break even.

Corporate costs are core value-dilutive factors

While the companies' operational assets are contributing much to their cash flow and value, their head offices are clearly value-diluting assets, as demonstrated in the valuation summaries provided in the sections below.

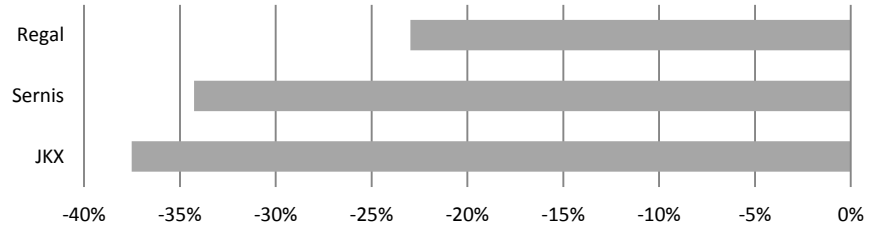
Ways to dilute negative value generated by corporate costs

Regal Petroleum managed to significantly cut all the expenses related to its London office with the entrance of a Ukrainian tycoon into its equity. The cost-cutting measures allowed it to slash its UK losses by about 15x over the last four years (refer to the next page for more details). As our valuation suggests, the costs of its London office are eating away at about 23% of the company's value generated by its operational subsidiary in Ukraine.

At the same time, JKX and Serinus are still keeping their corporate/head office costs at constantly high levels. Assuming these costs will be expanded in the future at the historically reported levels, corporate costs will eat away 34%-38% of their value generated by Ukrainian and Russian/Tunisian assets, we estimate. The way the companies can potentially reduce the negative contribution of their head offices on their total value may differ in the following way:

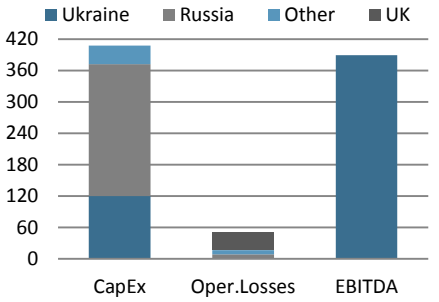
- There is no hope for cutting the representative office costs for Serinus (as keeping the costs high seems to be the strategy of its major shareholder). The core factor that could make these costs pay off would be new projects that the company is initiating. Among those projects is a Romanian oil & gas field that Serinus is planning to actively explore and/or develop in the coming months.
- The most straightforward way for JKX to diminish the negative contribution to its value of its London office could be the way pursued by Regal, i.e. a radical reduction of the costs of its London office. Refer to the next slide for more details.

How corporate costs dilute total value generated by operational assets**

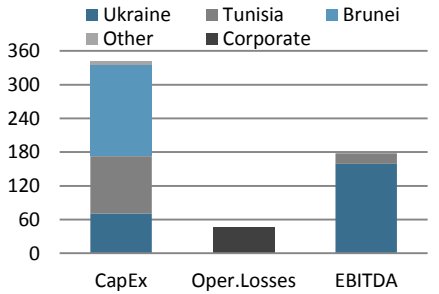


Aggregate expenditures and profits by region, 2011-2013, USD mln:

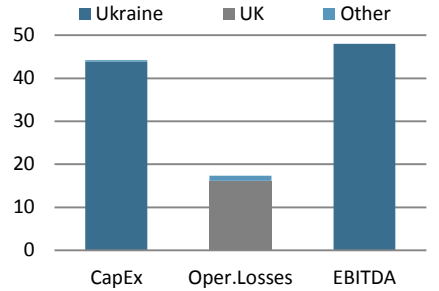
JKX



Serinus*



Regal



** For Serinus – net numbers for Ukraine (based on 70% working interest); **Based on our valuation of the companies – more details on the valuation are provided in the sections below. Source: Company data, Concorde Capital research*

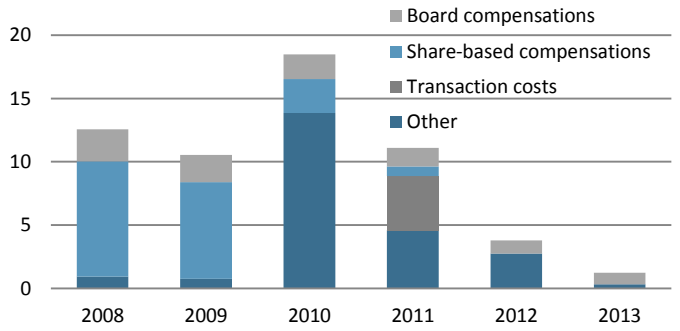
Case study - JKX vs. Regal: U.K. costs

With no majority shareholder in **Regal** before 2011, the company's management effectively controlled all its operations. Top management demonstrated an unlimited appetite for large spending on CapEx and OpEx, and Regal became quite efficient in wasting the money of its investors. Besides huge drilling costs in Ukraine (more than USD 20 mln per well), the company was very generous in spending money to support its London office and compensate its top management and board.

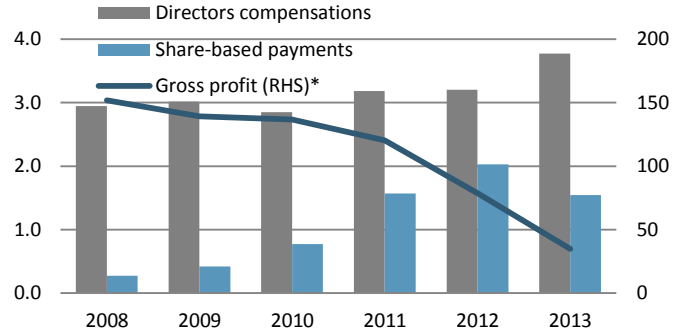
The situation has changed radically after the entrance of Ukrainian tycoon Vadim Novinsky as a majority shareholder. A subsequent strategic review and reduced influence of the London office led the company to slash its U.K. losses by 15x in 2013, compared to the peak levels of 2010. Perhaps the last value-destructive move of the London office was a payment of a USD 4.3 mln bill to advisors that preceded Novinsky's arrival.

JKX's current situation resembles what Regal underwent in 2008-2010. The company's top management fully controls all its operations and is very generous in assigning high bonuses and other payments for itself, disregarding the company's worsening performance over the last five years. Its board and management costs are increasing constantly, including an average 5.1% annual growth rate of top-management compensation in the last five years, showing a negative correlation with the company's P&L trend. We estimate that JKX currently holds a value growth potential, provided that it manages to cut its London costs. Our estimates show its U.K. operations could eat away up to USD 68 mln of the company's future value if no strategic review will be made.

Regal: history of UK office costs, USD mln



JKX: financial performance and management costs, USD mln



** Reported gross profit, net of exceptional items*
Source: Company data, Concorde Capital calculations

Corporate governance and investor relations

The gas E&P companies occupy top positions in our regular ratings of corporate governance and information transparency, with Serinus (formerly Kulczyk Oil) demonstrating the best results of the three covered companies, and Regal lagging of the three.

Disclosure of information

All the companies are openly disclosing their annual and semi-annual reports, as well as trying to timely update investors on their drilling progress and important workover operations. Still, the content and regularity of the disclosed information differs in many aspects:

- **Serinus Energy** provides detailed operating and financial data on all its assets, including production levels, operating costs and netbacks in all its core regions of operation. On top of that, the company is the only one to disclose regularly its quarterly operating and financial results.
- **Serinus** also publicly discloses its reserve reports of its operational assets, while **Regal** and **JKX** are hiding their reserve reports.
- **JKX** provides its production results inconsistently, disclosing breakdown of its production by regions with uncertain regularity. Production costs are disclosed in bulk, without differentiation by regions. At the same time, the company discloses regularly its well development plans.
- **Regal** is a simpler story, as it runs a single producing asset. Its semi-annual reports usually contain most of the necessary information on its activities. Though besides regular reports, the company rarely informs investors on its important events. The company also does not disclose the quantity of its operating wells.

Dividends

JKX is the only one of the three companies that has paid dividends. Until mid-2011, it was paying semi-annual dividends with its annualized yield having been usually close to 2%.

Corporate conflicts: value-driving factor?

In May 2013, two **JKX** shareholders – owning collectively 39% of the company's total shares – made an attempt to dismiss the CEO and commercial director, blaming top management for the poor financial and operational performance in 2011-2012 and significant devaluation of its share price. Yet the CEO persuaded the holders of 52% of the shares to reelect him. The company's board also preemptively restricted the shares of the revolting shareholders, Eclairs Group (which is reportedly related to Ukrainian tycoon Igor Kolomoisky) and Glengary Overseas, from voting at a June 2013 AGM.

The threat of losing their positions seems to have been a good splash of cold water for the company's top management. Ever since the revolt, they have paid much more attention to earlier overlooked Ukrainian assets. After restarting an intensive capital program in Ukraine last year, the company reached interim success in turning around production this year.

Companies places in Concorde ratings

	Informational openness 2013 (out of 100)	Corporate governance 2012 (out of 111)
Serinus	Top	# 7-15
JKX	#10	# 7-15
Regal	#46	# 16-19

Shareholder structure

JKX	
Eclairs Group	27.47%
Glengary Overseas	11.42%
Henderson Global	7.62%
Aberforth Partners	7.60%
Management	2.45%
Other	43.44%
Shares outstanding, mln	171.72

Regal	
Energees Management*	**54.0%**
CFT Holdings	24.4%
Pope AM	8.0%
Other	13.6%
Shares outstanding, mln	320.64

Serinus	
Kulczyk Investments*	**50.77%**
Pala Asset Holdings*	**7.48%**
Other	41.75%
Shares outstanding, mln	78.61

** Controlling shareholders*
Source: Company data, Concorde Capital research

Stock liquidity and performance

Representing the most liquid part of the Ukrainian equity universe

Amid the Ukrainian stock market, the three gas exploration and development companies are rather actively traded socks. The aggregate average daily turnover of the three stocks on their primary floors (London, Warsaw) was USD 413,000 over the last 12 months, which is comparable to the aggregate daily turnover of the ten components of the UX Index (USD 688,000), the benchmark that includes the most liquid stocks of the Kyiv-based Ukrainian Exchange.

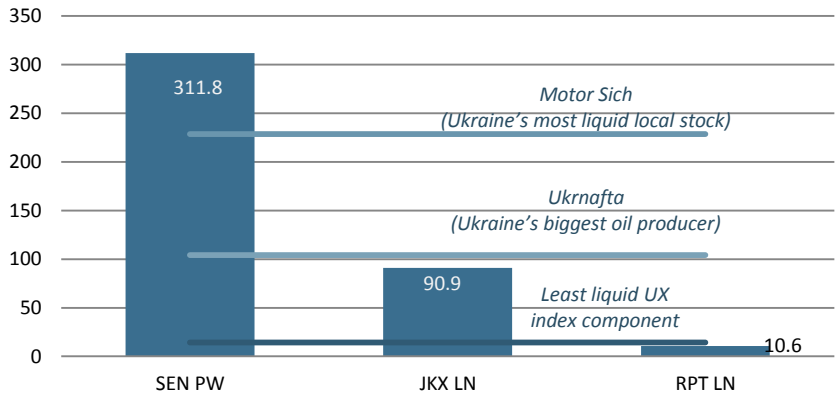
- Serinus (SEN PW) trades much more actively than Ukraine's most liquid local stock, Motor Sich, while JKX is traded on par with Ukraine's oil giant Ukrnafta.
- At the same time, Regal shares are much less liquid and their trading volumes are even less than that for the least liquid component of the UX Index, which is Ukrsotsbank.

Underperforming the UX index, but better than the WIG-Ukraine Index

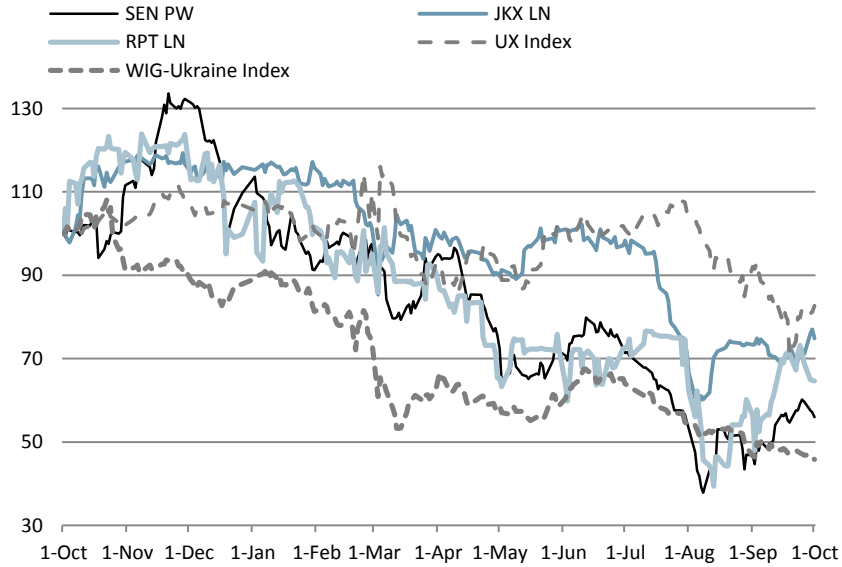
Over the last 12 months, the stocks of three gas E&P companies were on the declining price trend, broadly falling between the UX Index and the WIG-Ukraine Index, a benchmark for Ukrainian stocks listed in Warsaw. Naturally, the biggest price driver over the period was the introduction of a high gas extraction tax in early August.

- Up until the end of 2013, the best performing stock was Serinus Energy, whose Ukrainian fields demonstrated good results last year.
- In late 2013, the shares of Regal and Serinus fell significantly on news that Ukraine has decreased its marginal price since 2014 after gaining a nearly 1/3 discount from Gazprom for imported gas since Jan. 1, 2014. The shares of JKX, the firm more focused on the Russian market, suffered less.
- Another significant selloff in the three stocks happened in March 2014, when the Russian annexation of Crimea made investment into Ukraine more risky. Note that the local index did not react that sharply as the indices and prices of foreign-listed stocks.
- In May and in late June, with the escalation of the armed conflict in Donbas, another selloff occurred, which naturally affected Serinus the most.
- Finally, the August law introducing a 2.5x hike in the effective gas extraction tax in Ukraine until the year end resulted in gas producer share prices **plunging 23%-40%** during a span of two weeks at the end of July and early August. Similar price swings are possible once the Ukrainian government indicates, possibly in the next few months, whether it will extend its elevated subsoil tax rates into 2015 or longer. **A repeat of August is possible if our base-case assumption of a one-year prolongation comes true.**

Average daily turnover in the last 12M, USD '000



12M market performance, in USD terms (Oct. 1, 2013 = 100)



Source: Bloomberg, Concorde Capital calculations

Key stats for the three E&Ps

Operating and financial summary, USD mln, unless other stated

JKX Oil & Gas

	2013	2014E	2015E
Ouptut, mln boe	**3.45**	**3.61**	**4.71**
- Ukraine	1.75	1.75	2.03
- Russia	1.70	1.86	2.68
Sales	**180.7**	**157.4**	**194.4**
- Ukraine	151.0	126.3	150.9
- Russia	28.9	30.7	43.5
Sales net of royalty	**130.9**	**104.9**	**121.4**
- Ukraine	112.4	80.3	84.9
- Russia	22.0	24.3	36.5
EBITDA	**68.1**	**43.5**	**63.9**
- Ukraine	83.1	50.4	63.7
- Russia	4.2	2.4	9.6
CapEx	**64.4**	**36.0**	**39.5**
- Ukraine	41.7	26.0	31.5
- Russia	20.2	10.0	8.0
Net debt	**6.5**	**2.9**	**-12.0**
Sales, USD / boe	52.4	43.6	41.3
EBITDA, USD / boe	19.7	12.1	14.1
CapEx, USD / boe	18.7	10.0	8.4
1P reserves, mln boe	29.4		
2P reverses, mln boe	72.8*		
EV / Sales	0.8	0.9	0.6
EV / EBITDA	2.0	3.1	1.9
USD / boe:			
EV / Output	39.8	37.0	25.3
EV / 1P	4.7		
EV / 2P	1.9*		

Serinus Energy

	2013	2014E	2015E
Ouptut, mln boe**	**1.49**	**1.85**	**1.79**
- Ukraine	1.21	1.35	1.17
- Tunisia	0.28	0.50	0.62
Sales	**146.7**	**164.4**	**169.9**
- Ukraine	117.7	113.8	109.2
- Tunisia	29.0	50.7	60.7
Sales net of royalty	**112.2**	**111.9**	**98.7**
- Ukraine	87.4	68.5	46.3
- Tunisia	24.9	43.4	52.4
EBITDA	**71.8**	**71.7**	**69.8**
- Ukraine	70.5	56.3	36.1
- Tunisia	18.8	28.9	43.8
CapEx	**75.6**	**78.7**	**35.3**
- Ukraine	30.0	22.3	13.3
- Tunisia	2.7	36.2	22.0
- Romania	-	14.8	n/a
Net debt	**7.1**	**16.0**	**n/a**
Sales, USD / boe	73.0	67.7	74.1
EBITDA, USD / boe	35.8	29.5	30.4
CapEx, USD / boe	37.6	32.4	15.4
1P reserves, mln boe	6.8**		
2P reverses, mln boe	16.7**		
EV / Sales	1.1	1.0	n/a
EV / EBITDA	2.3	2.4	n/a
USD / boe:			
EV / Output**	107.8	91.6	n/a
EV / 1P	23.6**		
EV / 2P	9.6**		

Regal Petroleum

	2013	2014E	2015E
Ouptut, mln boe	**0.520**	**0.504**	**0.453**
- Ukraine	0.520	0.504	0.453
Sales	**36.7**	**34.1**	**31.2**
- Ukraine	36.7	34.1	31.2
Sales net of royalty	**29.6**	**25.9**	**21.7**
- Ukraine	29.6	25.9	21.7
EBITDA	**13.3**	**19.0**	**13.3**
- Ukraine	14.6	20.2	14.5
CapEx	**23.5**	**6.0**	**14.0**
- Ukraine	23.5	6.0	14.0
Net debt	**-25.1**	**-31.9**	**-29.8**
Sales, USD / boe	70.6	67.8	69.0
EBITDA, USD / boe	25.6	37.7	29.3
CapEx, USD / boe	45.1	11.9	30.9
1P reserves, mln boe	1.9		
2P reserves, mln boe	11.7		
EV / Sales	0.5	0.3	0.4
EV / EBITDA	1.3	0.6	1.0
USD / boe:			
EV / Output	34.3	21.9	28.9
EV / 1P	9.4		
EV / 2P	1.5		

** For JKX, 2P reserves exclude 21.4 mln boe of Rundekovskoye reserves; ** For Serinus, reserves and output data is net to the company's working interest. Per-boe P&L stats account for gross output numbers. Source: Company data, Bloomberg, Concorde Capital research*

Peer comparison

Company	Ticker	Key regions of production	MCap USD mln*	Multiples, USD / boe, 2013			Multiples 2014E	
				EV / 1P	EV / 2P	EV / Output	EV / Sales	EV / EBITDA
Novatek	NVTK LI	Russia	30,942	2.2	1.5	77	3.5	8.5
Exillon Energy	EXI LN	Russia	393	1.8	0.7	59	0.8	3.0
Victoria Oil&Gas	VOG LN	Cameroon	111	11.0	2.9	n/a	n/a	n/a
Tullow Oil	TLW LN	Ghana, Gabon, Eq.Guinea	9,318	n/a	31.7	394	4.8	8.3
Soco Int'l	SIA LN	Vietnam	2,034	n/a	13.5	287	3.2	3.9
PA Resources	PAR SS	Congo, Tunisia	44	35.6	23.2	193	3.1	5.0
Peer median				**6.6**	**8.2**	**193**	**3.2**	**5.0**
JKX Oil & Gas	JKX LN	Ukraine, Russia	131	4.7	1.9	40	0.9	3.1
Serinus Energy	SEN PW	Ukraine, Tunisia	154	23.6	9.6	108	1.0	2.4
Regal Petroleum	RPT LN	Ukraine	43	9.4	1.5	34	0.3	0.6

** Market prices as of Oct..1, 2014 close*
Source: Company data, Bloomberg, Concorde Capital research

Company focus: Regal Petroleum

Regal Petroleum: company profile

Real Petroleum entered the London Stock Exchange in 2002, attracting GBP 10 mln from an equity placement and more USD 105 mln from an additional placement in 2009. It operates two gas and condensate production licenses in the Poltava region, Ukraine. The company also held interests in Romanian and Egyptian assets, from which it divested in 2011 and 2012.

In 2010, the company lost its Ukrainian licenses due to a breach of some state requirements. With entrance of Ukrainian tycoon Vadim Novinsky into the company's equity (who bought a 54% stake in March 2011), the company was able to restore its license rights as soon as July that year.

The key feature that differentiates Regal from its Ukraine-focused peers is that its reserves have a depth of more than 5,000m, which makes them less vulnerable to a change in the gas production tax regime – its royalty rates for gas is 45%-50% smaller compared to its peers. At the same time, the large depth of its wells imply high drilling costs. This, as well as a relatively small number of operational wells (no more than 10 units), makes the company's value very sensitive to the drilling results of new wells.

While the company has been showing a declining rate of hydrocarbons drilling over the last three years, it recently improved its mix of hydrocarbons output to improve its profitability per unit extracted.

Investment case

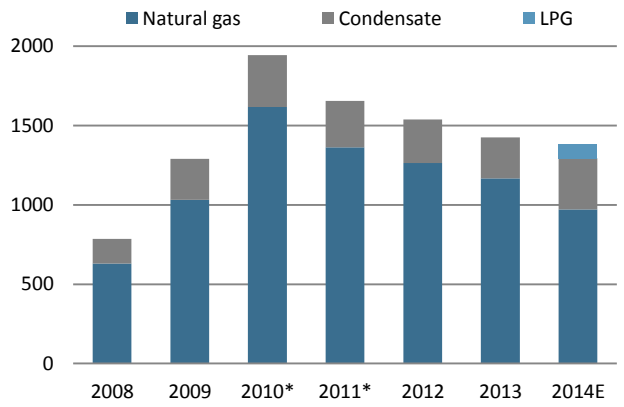
We initiate coverage of Regal Petroleum with a **BUY** recommendation and a target price of USD 0.196/share (implying a 46% upside). No single deviation from our base-case scenario implies an evaporation of the upside, based on our estimates.

The company seems to be overlooked due to its poor operational performance after a couple of its new wells failed. We estimate it has solid value growth potential should it maintain a historical success rate in its new wells in the coming years.

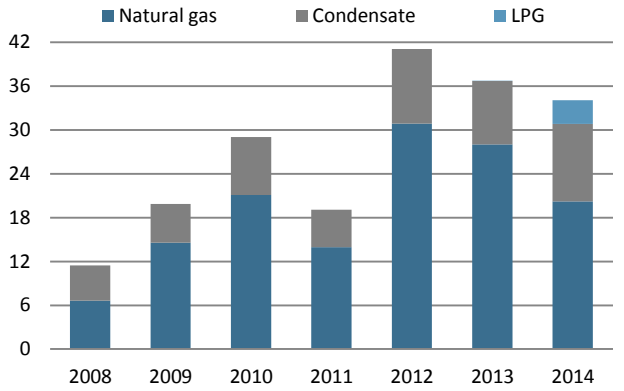
In the short term, the company looks like a less risky investment compared to its peers, as its value is less sensitive to possible prolongation of the temporarily hiked tax regime for Ukrainian gas producers. We estimate the company's current stock price has an upside potential even in case this risk occurs.

On a longer period of time, the core factor that will determine the Regal's value and market price will be the results of its new well drilling. The company has scheduled only one well for drilling in 2015 (out of a total of just 10 planned for the future). Clearly, the results of this well will determine the company's share price trend in 2015-2016. We estimated the sensitivity of the company's value to the government's taxation decision is 1.2x less than its sensitivity to the drilling results of a new well.

Hydrocarbon production, boepd



Revenue, USD mln



** The company was operational 320 days in 2010 and 161 day in 2011. The average production rate accounts only for the operating days of these years.*
Source: Company data, Concorde Capital research

Deposit base

Regal fully owns and operates two gas deposits in the Poltava region of Ukraine, under production licenses which it obtained for 20 years in 2004 with an option to extend them for 12 more years. Those two licenses are Mekhedivsko-Golotovschinske (**MEX-GOL**) and Svyrydivske (**SV**), though the company does not provide separate data on production or reserves for them, presenting them as a single asset. The area was discovered in the 1960s but not developed until Regal got involved in 1996.

Drilling: high cost – low success rate

Regal extracts the deposits from wells by drilling 5,000-6,300m, much deeper than its peers. Since such depth require special equipment and efforts, the company has incurred the highest drilling cost among its peers (refer to the next page for more details).

Over the last four years, the success rate of Regal's drilling operations was very low, with only one out of five projects meeting expectations. This, as well as lackluster results of wells workover and stimulation, has led to a gradual decrease of the company's output over the last three years.

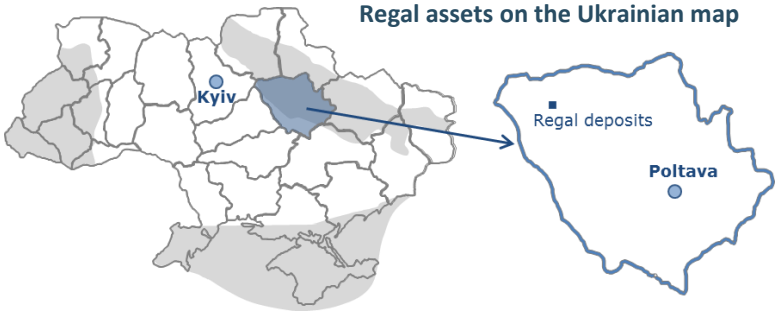
Reserves downgrade history

The overall poor performance of new wells, which inflated the total costs of Regal's projects, forced management to significantly revise its license developments plans. As a result of a series of strategic revisions, the company downgraded its estimate of 2P reserves 14 times over the last decade. It also did so with its drilling plan: while in 2008, the company presented its plan to drill up to 95 wells on its deposits, the plan was then downgraded to 25 and most recently to just 10 new wells.

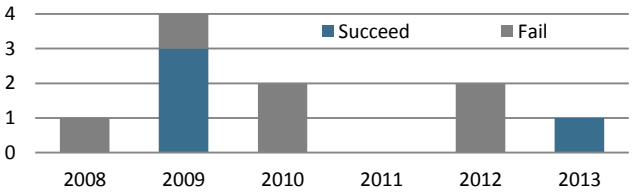
Rich gas

The company's deposits contain a large portion of condensate, and they offer gas that contains "fat" additions that enable the extraction of large amounts of LPG. In 2013, the company upgraded its gas processing facility to make LPG separation possible, and included LPG in its reserve base.

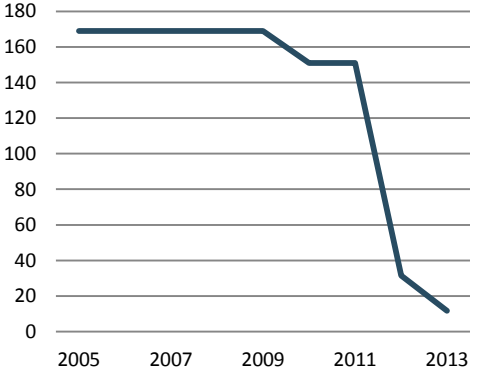
Regal assets on the Ukrainian map



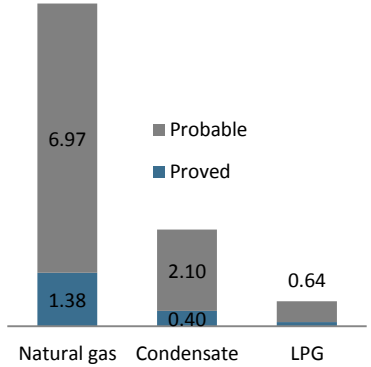
Results of new well drilling, units



Evolution of reported 2P reserves, mln boe



2P reserves, end-2013, mln boe



Source: Company data, Concorde Capital research

Operations: declining CapEx & output, improving sales mix

Declining CapEx appetites

With over USD 100 mln in equity financing attracted in 2009, the company had no spending limits for the development of its gas fields. In 2008, before its SPO, the company hired an international contract at an enormous cost, as compared to the sector benchmark: firmly above USD 20 mln/unit, or to drill its new wells we estimate.

In 2011-2013, following a strategic review, the company started working with local drilling contractors to significantly decrease the cost of its new wells to about USD 10-12 mln/unit, we estimate. This is still 3x-5x more than the drilling costs of its peers, which reflects the enormous capital intensiveness of Regal's deep reserves development.

Production: an interrupted success story

After the successful commissioning of three new wells in 2009-2010, Regal nearly doubled its gas production in mid-2010. Emboldened by such success, the company paid little attention to claims made by the Ecology Ministry, which eventually suspended Regal's production licenses in November 2010. The seven-month halt in production apparently decreased the production capacity of Regal's wells as its output never returned to pre-suspension levels.

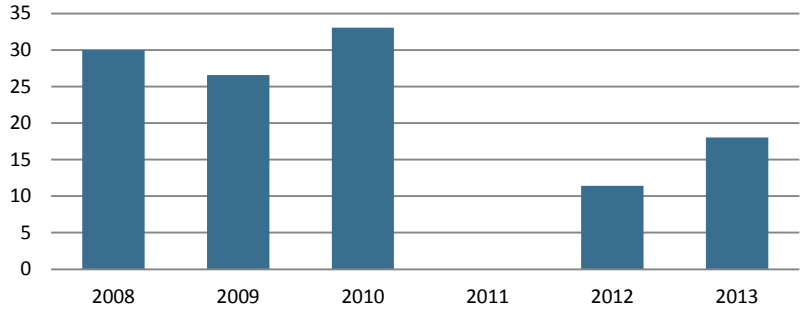
Since restarting its operations, Regal managed to commission only one new successful well, which was not enough for the company to increase its production.

Upgraded processing facility improves output mix

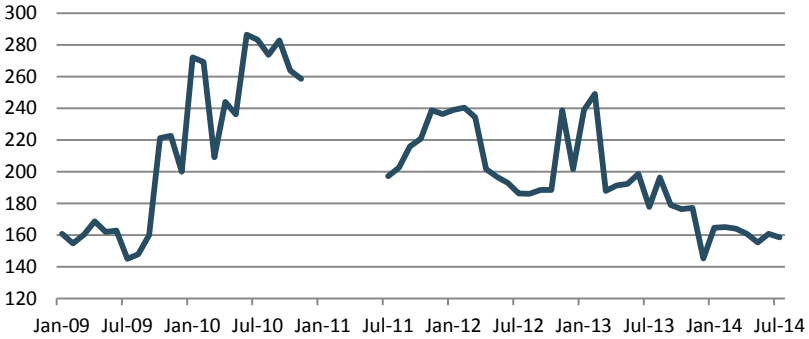
With the commissioning of its upgraded gas treatment facility in late 2013, the company started extracting LPG from its gas to gain additional revenue on this byproduct with a minor increase in costs.

As the company's recent operating data shows, it was able to increase the output of its condensate in 2014 as well, which we also attribute to more efficient processing.

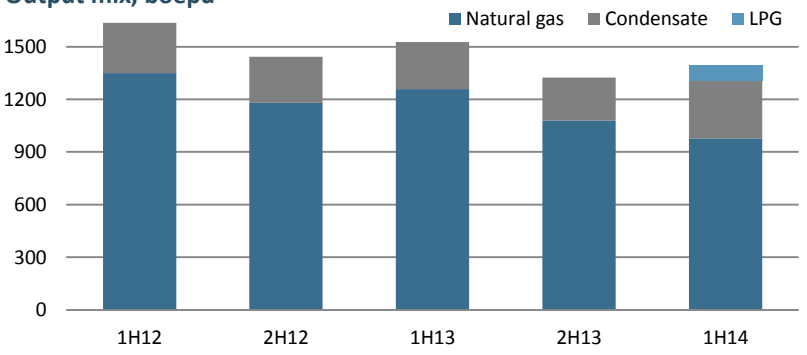
Total CapEx* / new wells drilled



Monthly gas production, tcm/d



Output mix, boepd



** Total CapEx in Ukraine, includes other investments, in addition to well drilling*
Source: Company data, Energobiznes, Concorde Capital calculations

Investments and their return: down to earth

Investments did not pay back

After its successful share placement in 2009, Regal started recklessly wasting money, as is evident today. The company's development plans were overly optimistic and were never to be backed up by a success rate needed from its wells drilling and workovers.

The intensive CapEx into new wells drilling in 2008-2010 did not lead to a respective increase in Regal's production, thus inflating its total expenditure per unit of gas. The low production tax that the company enjoys wasn't of much help either.

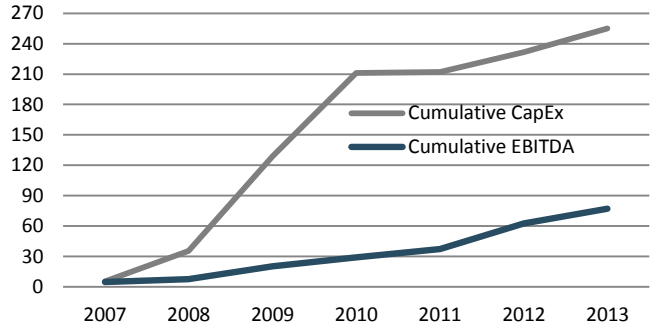
Asset base cleaned in 2013

With the company revising its plans to develop its Ukrainian gas fields, Regal significantly downgraded its economically extractable reserve base in early 2014. With this revision, the company wrote down USD 159 mln of its assets from its end-2013 balance sheet to make the asset base more reflective of its financial reality.

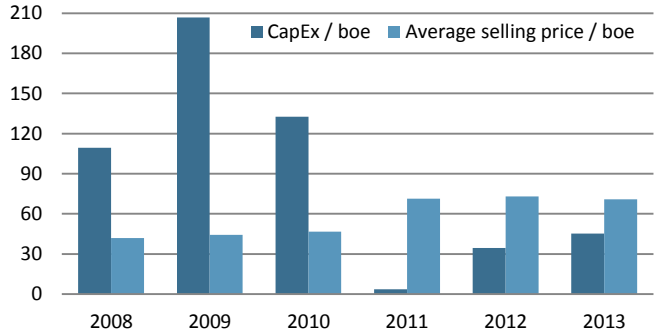
Costs, CapEx decrease in 1H14 with UAH devaluation, increased uncertainty

Regal's operating and general costs, in USD per boe terms, decreased 27% yoy in 1H14, compared to 2013. We attribute this to devaluation of the local currency, as most of the operating costs in Ukraine linked to the hryvnia. The company's capital expenditures were limited to USD 2.6 mln in 1H14, compared to USD 13.0 in 1H13, as the company hasn't been conducting new well drilling operations this year. According to its updated plan for 2014, Regal will not start new drilling work, while only concentrating on the workover of its SV-61 well and fracturing its two wells at the MEX field. It is going to renew drilling operations in 2015, with one well to be spudded.

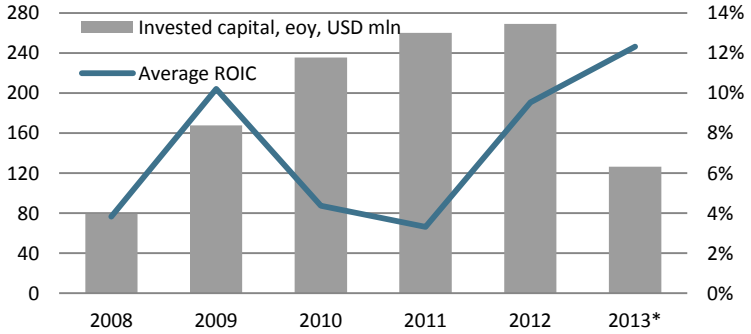
Ukrainian investments and payback, USD mln



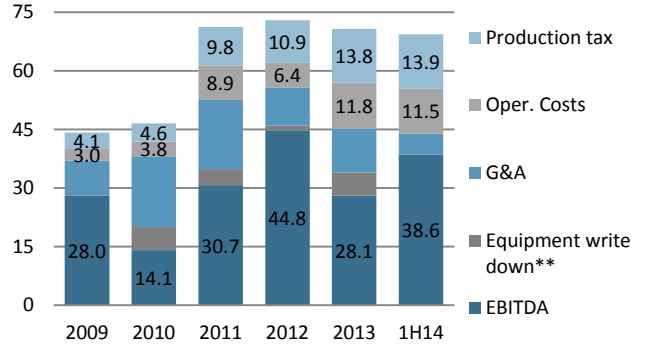
Key indicators, USD/boe



Invested capital and return



P&L stats, USD / boe



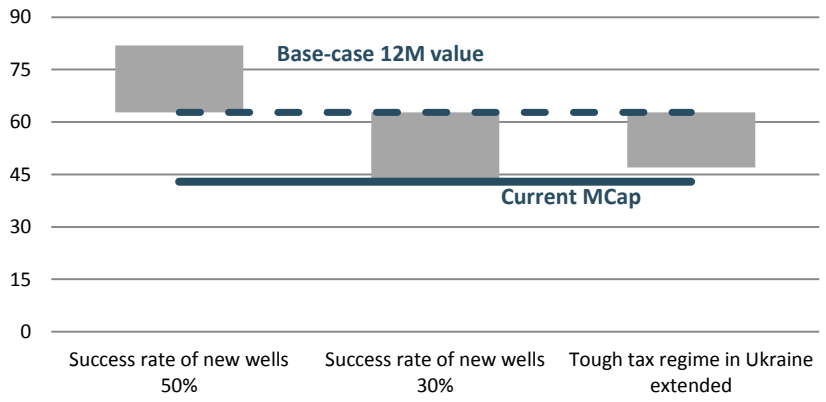
** ROIC = operating profit divided by average invested capital (for the 2013 ROIC calculation, we adjusted the average level of invested capital to for the level of total assets written down); ** One-off, non-cash costs related to the write down of equipment that Regal decided not to use anymore.*
Source: Company data, Concorde Capital research

Valuation summary of Regal

Valuation summary

	USD mln	USD/boe of 2P	Per EBITDA '2015
Ukrainian assets	40.8	3.5	2.8
UK costs	-9.9		
Total EV	**30.9**	**2.6**	**2.3**
Net cash, end-'14	31.9		
Equity value	**62.8**		
Current MCap	42.9		
Implied upside	**46%**		
Peer median		**8.2**	**5.0***

Equity value range, depending on assumption change, USD mln



We are basing our target price for Regal on DCF valuation. The derived MCap target is USD 62.8 mln (USD 0.196/share), which promises a 46% upside to the current market price.

We are assigning a **BUY** recommendation for Regal, based on our valuation. We note that its fair equity value is above the current MCap (+10%, we estimate) even if we account for the core downside risk, which is an extension of the tougher taxation regime for gas producers imposed recently by the Ukrainian parliament.

The core assumptions and details of the valuation are provided in the following slides.

The core downside factors for our value estimate of Regal are:

- High production-based taxes, implemented temporarily for 2H14, possibly being prolonged for the future periods. Since the company enjoys the lowest possible production tax rate, this development would not harm its value much. The total effect on the company's value will be up to USD 15.8 mln.
- Poor results of its upcoming drilling campaign. The company's deep deposits demand high-cost drilling, making Regal's value very sensitive to its drilling results. Clearly, the results of a newly planned well (MEX-109) will be important for understanding the company's true value.

The core upside factor for our value estimate is:

- Successful drilling of its new well. Our base-case scenario assumes that only four out of 10 projected wells will be successful for Regal (which is based on the company's past performance). Each extra successful well, compared to our base-case assumptions, will add about USD 19.1 mln to the derived company value. The core problem is the success rate is hard to estimate in advance. It may take a couple of years to check the validity of our assumptions.

In essence, an end to a harsher tax regime for Ukrainian gas producers for the next year would be a powerful price catalyst for the stock.

** EV / EBITDA for 2014*
Source: Company data, Bloomberg, Concorde Capital research

Operations modeling – core assumptions

Timing:
We assume that the company will be operational until the year 2036, thus assuming that its development license (expiring in 2024) will be prolonged for 12 years, according to the option that Regal has. By that time, the company should have extracted about 90% of its 2P reserves, as our further estimates show.

Forecasting period is chosen to be until the year 2024

Capital expenditures / new wells drilling
The company is planning to drill 10 new wells on its licensed areas – we model they will be completed by 2019, i.e. five years before Regal's current licenses expire.

- The first of the ten wells will be spudded in 2015 and commissioned in 2016. All the other wells are assumed to be drilled in respective years, as we show on the chart to the right, and commissioned in the following years.
- The cost of new wells drilling are assumed to be USD 9 mln per unit, which is about a 20% increase in UAH terms compared to the levels estimated for 2011-2013 (USD 12 mln/unit).
- Other CapEx is assumed to be USD 5.0 mln each year in until the current license expires in 2024, and USD 3.0 mln afterwards.

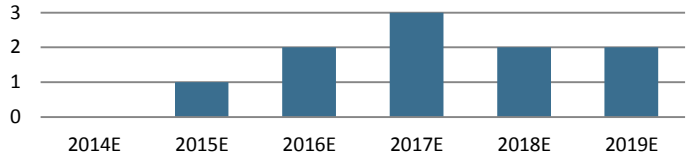
Success rate, yields of new wells
We assume the success rate for Regal's new wells at 40%, which is consistent with the company's performance over the last seven years. To apply this assumption, we model that each new well will yield 40% of Regal's last four successful wells, which will result in an average yield of 173 boepd in the first year of a new well's operation.

The decline rate of production for all wells is assumed to be 10% p.a., as is hinted by Regal's history.

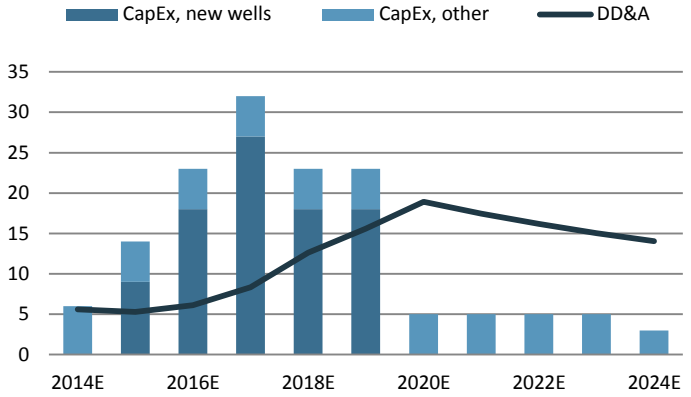
Prices and revenue mix

- The Ukrainian *marginal* gas price is assumed to be USD 11.5/tcf (USD 406/tcm), as discussed on page 10. We assume Regal will sell its gas at a 4.5% discount to the marginal price, as hinted by its experience.
- Prices for condensate and LPG are assumed to be constant at USD 90/bbl and USD 440/cm, respectively.
- The product mix sold by Regal is assumed to be proportional to the mix presented in company's last reported 2P reserves, which results in average price per boe sold of USD 68.7 for the whole forecasting period.

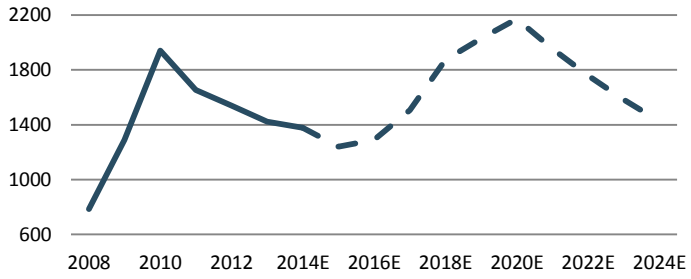
New wells drilling outlook, units



CapEx vs. depreciation, Ukraine, USD mln



Output, boepd



Source: Company data, Concorde Capital research

Operations modeling – core assumptions (cont'd)

Taxation
An interim high production tax rate for natural gas producers (see page 11 for more details) is expected to be prolonged for 2015 and eliminated in 2016, which implies a 28% tax rate in 2015, and 15% tax rate (8.3% rate for new wells for their first two years of production) since 2016. The effective tax rate for condensate is expected to be stable at about 40% of its price.

Depreciation, depletion & amortization (DD&A) is assumed to be a ratio of 2P reserves decrease per year to year-start total assets.

Production costs per boe of all hydrocarbons produced are assumed to be USD 11.2/boe in 2014 (vs. USD 11.5/boe in 1H14), and will fall further to USD 10.0/boe in 2015. Costs inflation afterwards is assumed to be 2% p.a.

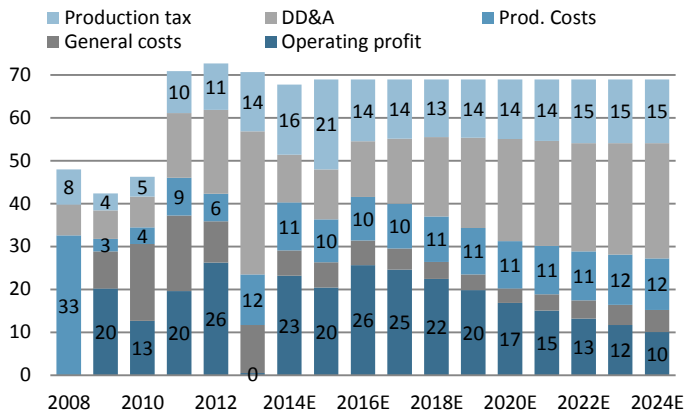
The general and administrative costs of Ukrainian assets are assumed be USD 3.0 mln in 2014 (vs. USD 1.4 mln in 1H14), and assumed to fall further to USD 2.7 mln in 2015, remaining stable afterwards.

Profit tax is assumed to be 19% in Ukraine.

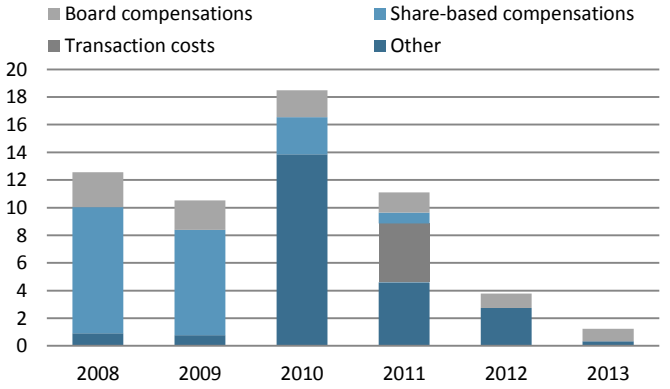
Other assumptions used for DCF modeling purpose:
- Working capital changes are assumed to be zero for the whole forecasting period
- Discount factor: 15% p.a.
- Number of years in operation after the explicitly forecasting period: 12
- Growth rate during the post-forecasting period: -8%
- UAH / USD for the future periods is assumed to be 12.5x

U.K. assumptions
With the entrance of a majority shareholder into Regal in 2011, the company significantly decreased the costs of its London office, which were cut from a peak level of USD 18.5 mln in 2010 to just USD 1.2 mln in 2013. We assume the annual costs of the U.K. office will be at USD 1.2 mln level in 2015, will increase 2% p.a. by the year 2014, and remain stable afterwards (until 2036). These costs will provide a negative DCF-based value of Regal's U.K. operations at USD 9.9 mln, according to our estimates (based on the 15% discount rate assumption).

Revenue, costs and profit in Ukraine*, USD/boe



U.K. costs of Regal, USD mln



**Operating costs for 2010-2013 exclude one-off costs of equipment write down*
Source: Company data, Concorde Capital research

Ukrainian assets: Valuation output

DCF valuation output, Ukrainian assets, USD mln

	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	Terminal
Taxed operating profit	11.9	7.5	9.8	11.0	12.4	11.9	10.8	8.7	6.9	5.5	4.3	
DD&A	5.6	5.3	6.1	8.3	12.6	15.6	18.9	17.5	16.2	15.0	14.0	
Capex	-6.0	-14.0	-23.0	-32.0	-23.0	-23.0	-5.0	-5.0	-5.0	-5.0	-3.0	
FCF	**11.5**	**-1.2**	**-7.1**	**-12.7**	**2.1**	**4.5**	**24.7**	**21.2**	**18.1**	**15.5**	**15.3**	
Dicounted FCF (mid-2015)		**-1.2**	**-6.2**	**-9.6**	**1.4**	**2.6**	**12.3**	**9.2**	**6.8**	**5.1**	**4.3**	**16.2**

Total value of Ukrainian assets of Regal, based on the above assumptions, is estimated at USD 40.8 mln as of mid-2015, or USD 3.5 per boe of the last reported 2P reserves.

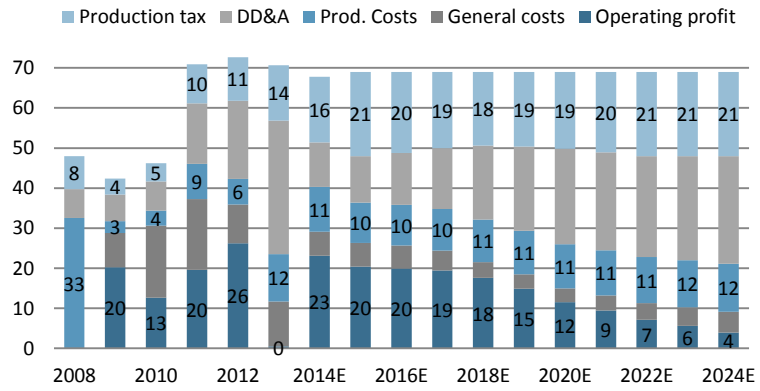
Modeling a permanent high production-based tax

If the Ukrainian government fixes the current production-based tax for gas permanently (implying a 28.0% tax rate for gas produced from existing wells and 15.4% from new wells), the total value of the Ukrainian assets of Regal would be USD 25.0 mln (USD 2.1 per boe of 2P reserves), all other things being equal. Note that due to the discounted tax rate for Regal, the divergence of the value of its Ukrainian assets from base-case is not as deep as for its peers.

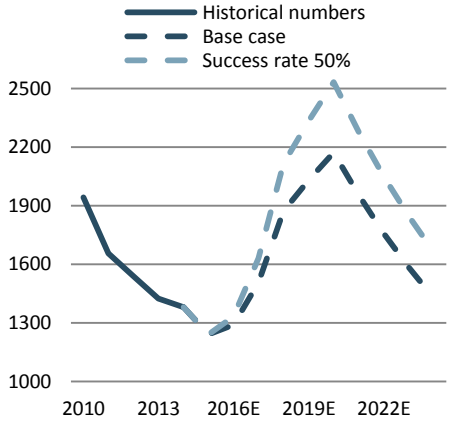
Modeling different success rates for new wells

In our base-case, we assume that the success rate for drilling new wells will be the same as over the last seven years (40%). If we apply an assumption of a 50% success rate for new wells (ceteris paribus), the company's assets will be valued at USD 59.9 mln (or USD 5.1 per boe of 2P reserves). Each 10% success rate (each successful well) adds nearly USD 19 mln to Regal's value, we estimate.

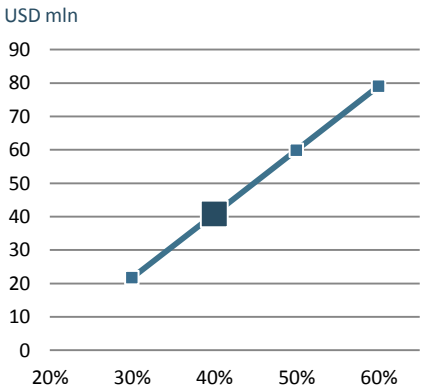
Revenue, costs and profit, USD/boe: assuming high production tax



Regal output, boepd, by scenarios



Value sensitivity to wells success rate



Source: Company data, Concorde Capital research

Company focus: JKX Oil & Gas

JKX Oil & Gas: company profile

JKX Oil & Gas entered the London Stock Exchange in 1995, attracting GBP 41 mln from its equity placement. Its operations started in the Poltava region of Ukraine. Gaining some experience in the upstream oil & gas business in Hungary, Turkey and Bulgaria, the company has shifted its focus on two countries, Ukraine and Russia. In Russia, it acquired a redevelopment license in 2007 and started gas production in 2012.

Currently, JKX's core assets are six gas-bearing reserves in Ukraine, one production area in Russia and one minor asset in Hungary. The company also has exploration (non-producing) licenses in Russia, Hungary and Slovakia. This year, it exited a small Bulgarian exploration project.

Investment case

We initiate coverage of JKX with a **SELL** recommendation at a target price of USD 0.66/share. Our target price implies a 13% downside. The core risk that Ukrainian high production tax to become permanent, if fulfilled, would deepen this downside further.

Despite our bearish result of valuation, we note that JKX still has value growth potential that might be unlocked in the short- to mid-term. The biggest potential upside to our target, in its size, is the successful development of JKX's Rudenkovskoye field (holding 65% of the total Ukraine-based 2P reserves), which we totally ignored in our valuation. Thus far, however, we see more risk that all of the field's reserve base will be written down – none of the three exploration wells have been successful, and the company's delay to develop this biggest field points to there being nothing economically extractable there.

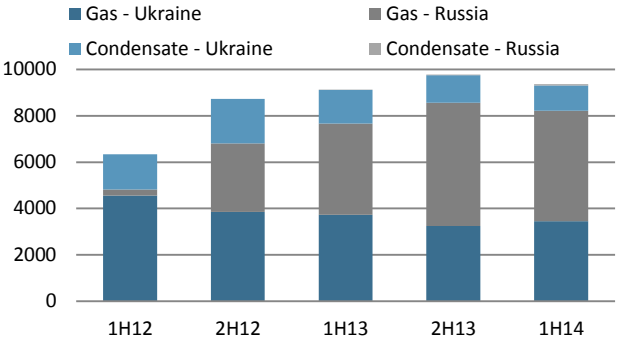
In addition, JKX suffers from an unusually high discount when selling its gas in Russia which, if eliminated, would triple the value of its Russian assets. Thus far, the probability of such an event looks unclear to us.

Another possible driver for value growth, which is solely under the control of shareholders, could be reduced costs in its London headquarters, which eat away more than a third of the company's value generated by other assets, based on our estimates. Some strategy review should happen with the company to realize this potential, which does not look realistic with the current top management.

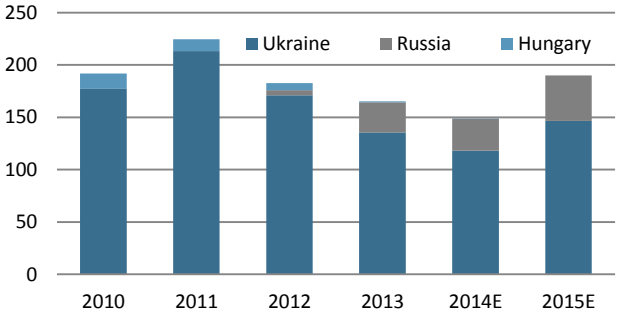
The company's exposure to Russia is unlikely to pay back, but the stock market seems to have already accounted for the failure of this asset.

Among the positive upcoming price triggers could be an upgrade of JKX's reserves at the successfully tested Elizavetovskoye field in Ukraine. Among the possible negative triggers for JKX's stock market price could be a downgrade of its Russian reserves base, as the pricing assumption in its reserves estimate seems to be no longer realistic.

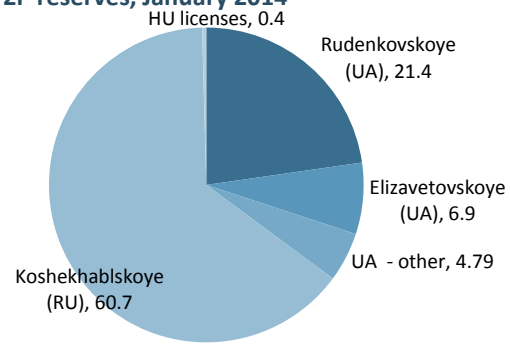
Hydrocarbon sales, boepd



Net revenue, USD mln



2P reserves, January 2014



Source: Company data, Concorde Capital research

Ukrainian assets

JKX's Ukrainian assets include:

The Novo-Nikolayevskoye Complex (NNC), which consists of five licenses:

- Ignatovskoye (**IG**)– **the biggest contributor to the company's proven reserves and production in 2013**, with 10 operational wells and a plan to drill one more by the end of 2014 and one in 2016. This area is the richest in condensate (43% of total hydrocarbons in its 2P reserves).
- Molchanovskoye (**M**)– **the most depleted area** in the complex with 24 operational wells and no further plans to drill more in the next two years. It also is rich in condensate (27% of its total 2P reserves).
- Novo-Nikolayevskoye (**NN**)– operates nine wells with mostly natural gas being mined (82% of its reserves). Its new NN-80 well was tested at an 1 mcf/d rate in 2014, with no new wells planned there.
- Rudenkovskoye (**R**)– **the least developed and least studied production field in the Complex, which contains only 4% of JKX's Ukrainian proven reserves and 65% of its 2P reserves.** However, it seems the reserves data stems from Soviet-era estimates. The results of the last drilling and fracking in this field (the R-103 well) were not successful, which makes this area the most risky for the company, in terms of a future 2P reserves downgrade. **The company postponed drilling programs many times there (the last well was drilled in 2010).** JKX revealed a plan to drill one more well in this area in 2014 and three more in 2015-2016. Being conservative, we expect that the next two drilling attempts will be unsuccessful and will lead to a downgrade of the field's reserves.
- Zaplavskoye (**ZA**) exploration license – **the smallest current asset at the Complex**, with no proven and little probable reserves. Two wells drilled there in 2012-2013 failed to meet expectations. A new exploration well is to be drilled there not earlier than in 1H15, according to the company.

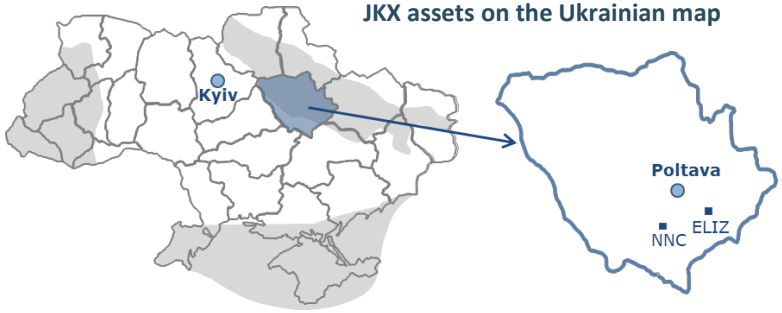
The Complex has a gas processing facility that also produces LPG.

The Elizavetovskoye license (ELIZ) that has been recently upgraded from an exploration to a 20-year development license is located 45 km away from the NNC in the same Poltava region. **It is JKX's most prospective and best performing asset of late**. The company is relying on this field to boost its gas production in Ukraine and it has just completed a project to double the field's gas processing capacity to 30 tcf/d. Its drilling program includes initiating one new well in 2014. Clearly, Elizavetovskoye is a candidate for the upward revision of its 1Pand 2P reserves as of end-2014.

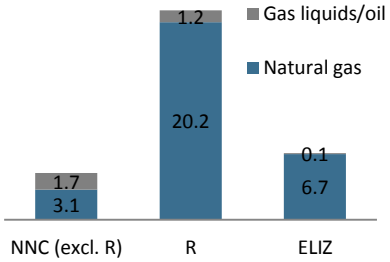
The core drawback of the Elizavetovskoye deposits is that they contain no valuable byproducts like condensate.

In 2012-2013, JKX received some revenue flow in the area due to the renewal of a legacy well, where it shared production on a 33%/67% basis with a state company.

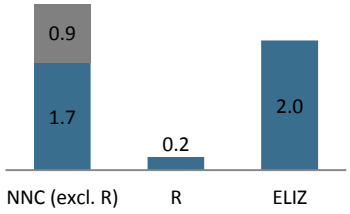
JKX assets on the Ukrainian map



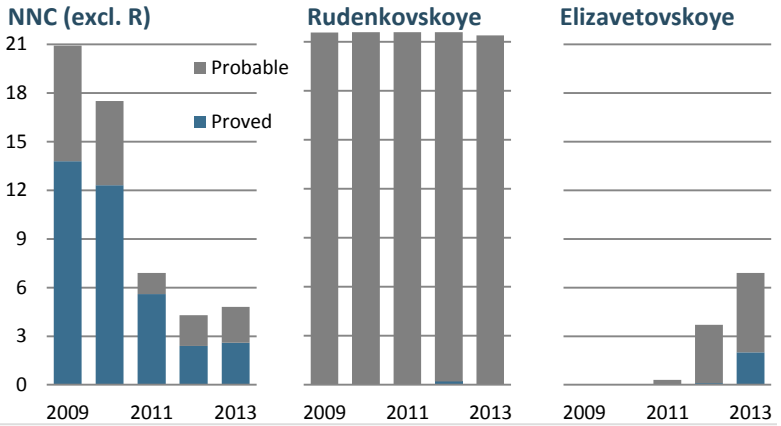
2P reserves by area, mln boe*



1P reserves, mln boe*



Change in reserves, mln boe:



** As of end-2013*

Source: Company data, Energobiznes, Concorde Capital research

Ukrainian assets performance

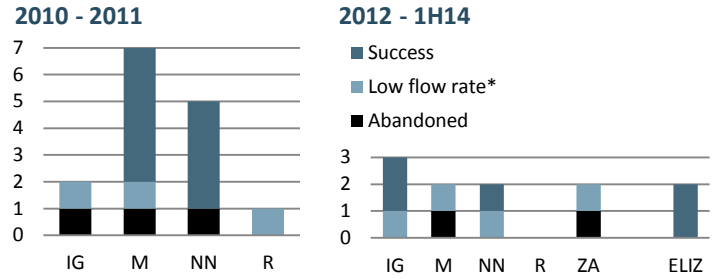
As JKX began shifting its focus on developing its Russian assets in 2010, capital expenditures in Ukrainian fields plunged in 2011-2012. Decreased drilling activity, as well as a lower success rate in drilling operations, resulted in declining output from Ukrainian fields since 2011. Only after pressure from JKX's largest minority shareholder did the company's top management decide to intensify its Ukrainian operations in 2013. This, as well as successful results from developing the Elizavetovskoye field in 2014, enabled the company to turn around in terms of output.

The Novo-Nikolayavskoye Complex (NNC):
As drilling activity and the success rate of new wells decreased in the Complex over the last two years, JKX focused more on workover and stimulation works there. But these efforts were not enough to halt the declining hydrocarbons output from these areas.

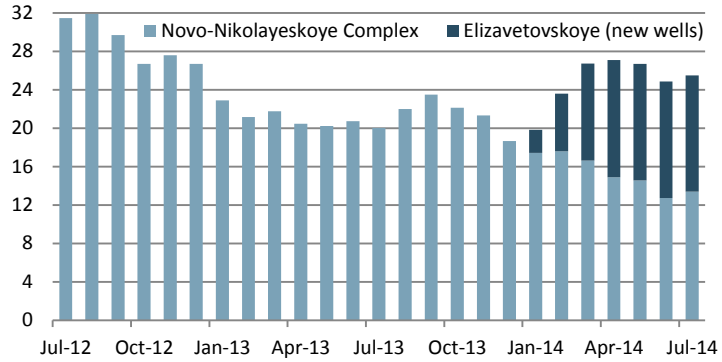
Elizavetovskoye (ELIZ):
With its two debut exploration wells having been successfully commissioned in 1Q14, this area provided 32% of JKX's total Ukrainian output in 1H14 and more than 50% in recent months.

The success in this area will allow JKX to at least stabilize its hydrocarbons production in Ukraine in 2014. Unfortunately, the reserves contain little condensate, which will lead to a decreased average price of hydrocarbons that JKX will sell in Ukraine. At the same time, if the company will successfully commission more wells at ELIZ, it will decrease its average production tax since those commissioned after July 2014 will qualify for a lower tax. The reduced tax will offset the negative effect of a poorer sales mix at ELIZ to the boost the average netback from JKX's Ukrainian operations.

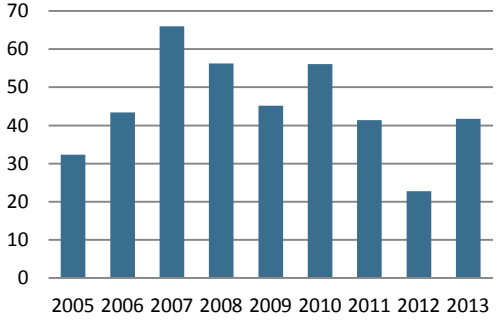
New well drilling results by area, units:



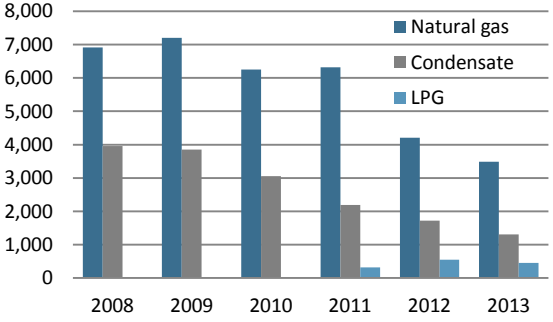
Gas production breakdown by location, tcf/d



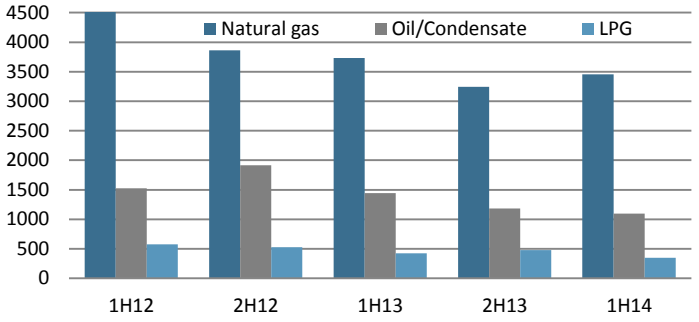
Capital expenditures in Ukraine, USD mln



Annual hydrocarbon sales, boepd



Semi-annual hydrocarbon sales, boepd



** These are cases in which drilled wells produced flow significantly below their peers in our view, or when the company reported unsatisfactory test results, with no information available as whether or not they have been abandoned.*
Source: Company data, Energobiznes, Concorde Capital research

Russian assets and operations

In Russia, JKX controls :

The Koshekhablskoye (KOSH) development license in southern part of Krasnodar region (Republic of Adygea). The area was discovered in 1972 and activity was suspended there in 1996. JKX purchased it in 2007 with redevelopment aims. After the reconstruction of its gas treatment plant and workover of five wells at the field, JKX started producing gas there since 2Q12.

The renewal was successful enough to prompt the company to boost the processing capacity of its gas treatment facility quickly. In 2012, it invested in raising processing capacity to 40 mcf/d and is currently investing in its further upgrade to be able to process up to 60 mcf/d.

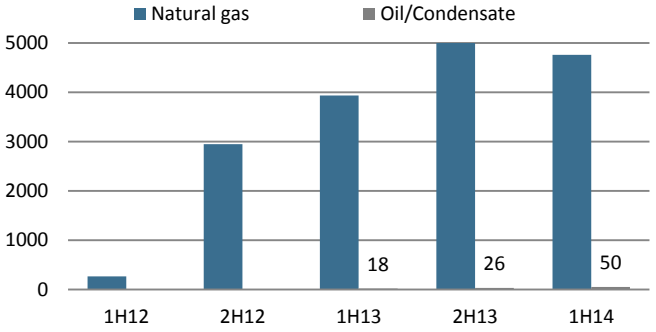
There are no visible plans to restart and workover other wells in the field, according to the company's latest update. No new wells are planned there.

The field's hydrocarbon reserves are extracted from deep wells of up to 5,700 m. The share of condensate in its total reserves and production is less than 1%, which is much less than JKX's Ukrainian assets.

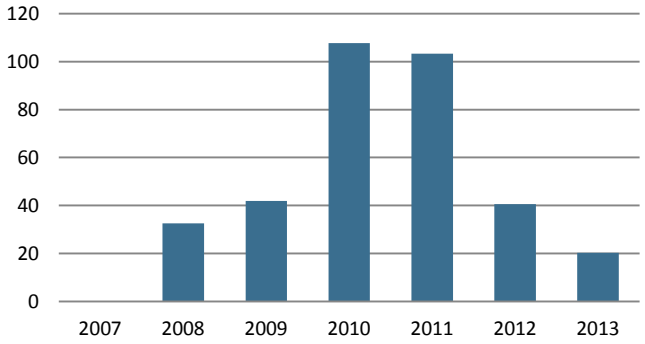
The Georgievskoye exploration license for the area surrounding the KOSH fields is considered to be an extension of the Koshekhablskoye license. The five-year license was acquired in May 2012 and carries a "drill or drop" clause, obliging the firm to drill two exploration wells until its expiration. Given the high costs of drilling (which may exceed USD 10 mln per well due the reserves' depth) and non-encouraging gas pricing outlook on the Russian market, we do not expect the company will meet the license conditions by mid-2017.

Location of JKX Russian assets

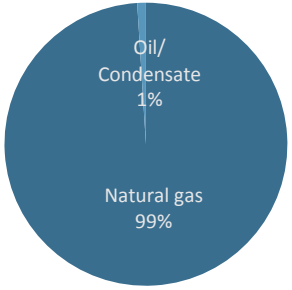
Semi-annual hydrocarbon sales in Russia, boepd



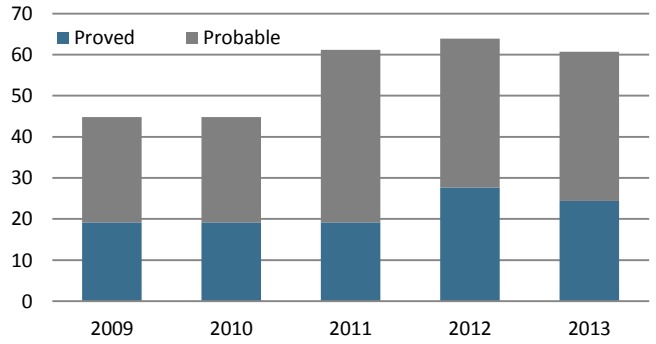
CapEx into Russian assets, USD mln



2P reserves breakdown



Russian 2P reserves, mln boe



Source: Company data, Concorde Capital research

Ukraine vs. Russia: profitability differs much

It's increasingly clear now that a higher focus on Russia by JKX was value-destructive, given the low gas pricing on the Russian market and little growth prospects. The only positive result achieved by the company from its high exposure to Russia was an increase in its overall hydrocarbon production. However, the escalated Russian share in JKX's total output mix made the average prices of gas and average profit per unit of gas shrink rapidly.

Prices comparison

The prices for gas on both the Ukrainian and Russian markets are capped by regulators, but their ability to cap prices differs greatly. The Ukrainian gas price cap is 4x-5x higher than in Russia and it's broadly linked to U.S. dollars, as a core factor that defines it is the price of imported gas to Ukraine (refer to page 10).

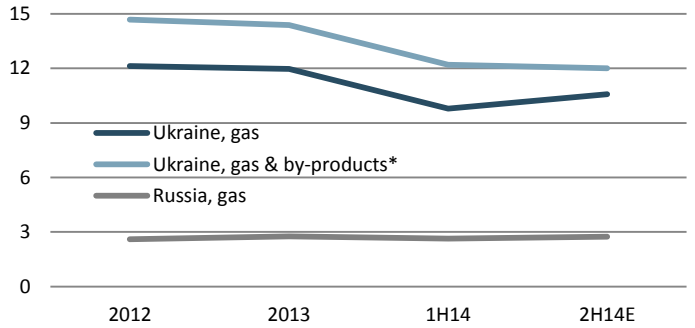
In Russia, JKX has no ability to export gas to Ukraine, so it has to sell domestically, where prices are much weaker. Another disadvantage is domestic prices in Russia are not directly linked to any hard currency. On top of that, JKX is selling its gas in Russia at a deep discount to the capped price existing in Russia (page 41).

In Ukraine, JKX is producing byproducts such as LPG and condensate, which is priced higher than gas, per boe. The total share of byproducts in JKX's Ukrainian revenue was 39% in 2013. In Russia, the share of expensive byproducts in its total sales mix is much smaller (3% of revenue in 2013).

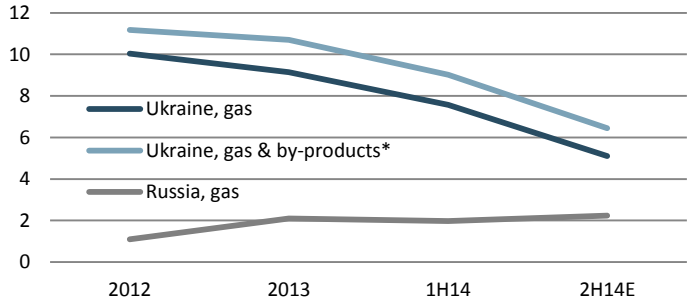
JKX's Ukrainian assets suffered from the two gas production tax hikes this year, with the second one being especially painful (see page 11). In Russia, the production tax rate is smaller and it has even declined since 2H14.

But even a painful (and possibly temporary) tax hike in Ukraine for Aug.- Dec. 2014 makes net Ukrainian prices nearly 3x better than in Russia in 2H14. For 2014, we expect the per-boe EBITDA of JKX's Ukrainian operations will be 8x higher than for Russian assets.

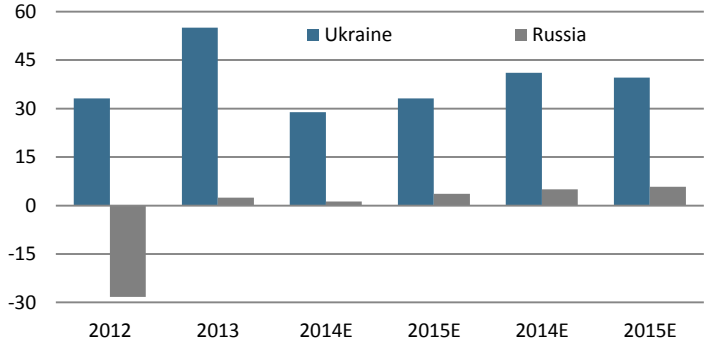
Average output prices by country, USD/tcf



Prices net of production taxes, USD/tcf



EBITDA, USD/boe, by location



** Revenue from sales of gas, condensate and LPG (in cubic feet equivalent of gas) divided by amount of gas and condensate sold*
Source: Company data, parliament, Energobiznes, Concorde Capital research

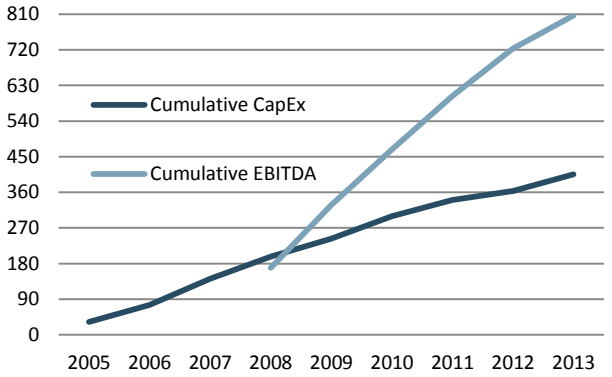
Russian assets add much to total output; drain capital from Ukraine development

When JKX's Russian assets started producing gas, the company's total production, in physical terms, started recovering after a four-year decline. Yet due the huge difference in market prices for gas in Ukraine and Russia, the Russian operations did not add much to the company's top line, which continued to shrink in 2013 and this year as well.

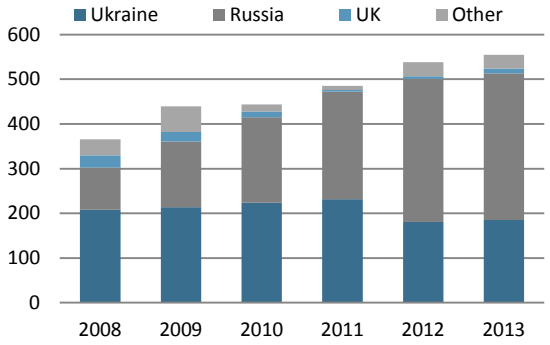
At the moment, JKX's entry to Russia looks like a huge waste of money as the invested capital has not provided a return. Moreover, the performance of its Ukrainian operations worsened during the time of active investment into Russian assets, which might be a result of underinvestment.

That's not to say the Ukrainian operations would have been much better if all the money spent for Russia had come this way. However, a comparison of the historical returns on capital invested in the two countries suggests that the company's value would have been much higher if it developed the Ukrainian direction more actively.

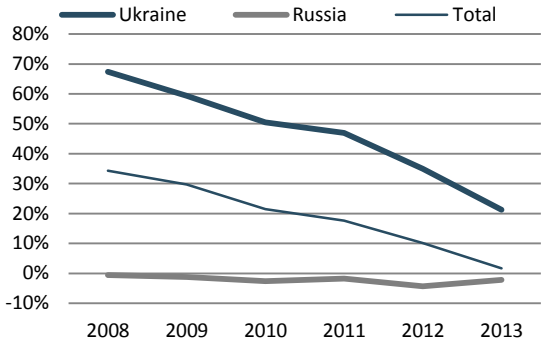
Ukrainian investments and return*, USD mln



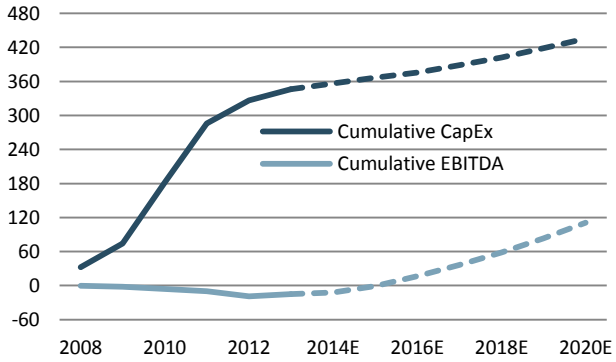
Invested capital by region, USD mln**



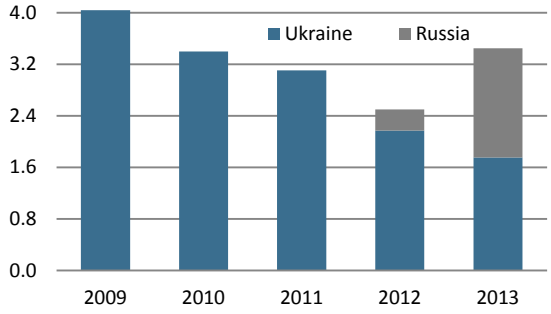
ROIC by region**



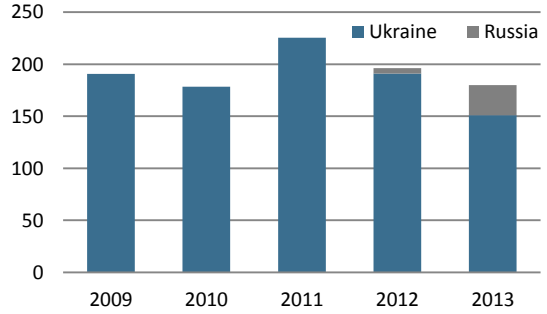
Russian investments and return, USD mln



Sales of hydrocarbons, mln boe



Revenue, USD mln



** CapEx and EBITDA numbers based on all the available historical data for JKX; ** Invested capital (IC) is defined as total assets less current liabilities; ROIC (return on IC) is defined as ratio of PBIT to average IC. Source: Company data, Concorde Capital research*

Betting on improved pricing in Russia won't work

The idea of investing into Russian redevelopment looked not so bad in its beginnings. It involved taking an overlooked gas field and re-commissioning conserved wells to gain stable gas and revenue flow with low CapEx spent. While this works perfectly in Ukraine (where private firms pick up wells abandoned by state producers and sell gas from them at 10x-14x higher price), that approach does not work in Russia.

Price growth assumptions do not work

The core bet on the Russian story was the market regulator will allow a 15% p.a. growth in wholesale gas prices from 2010 to 2015. Such growth should have turned this loss-producing business into a hen laying golden eggs. In March 2014 , JKX reiterated its positive outlook on gas prices in Russia, based on Russian government plans. However, based on the recent forecasts of the Russian Federal Tariff Service, gas prices for industrial consumers (which indeed increased 15% last year) will only grow 8% this year, at a 4.2% CAGR over the next three years (in local currency terms). In USD terms, the growth should be negative in 2014, due to devaluation of the ruble.

Assuming no further ruble weakness, the 2017 price of gas in Adygea will increase only 6% in 2017 from 2014 levels, in USD terms. Instead, JKX was counting on 83% price growth till 2017, according to its March 2014 presentation.

We see a high risk **that JKX will significantly downgrade its expansion program in Russia and 2P reserves in its Russian assets** if it adopts new gas pricing assumptions, as presented by the Federal Tariff Service.

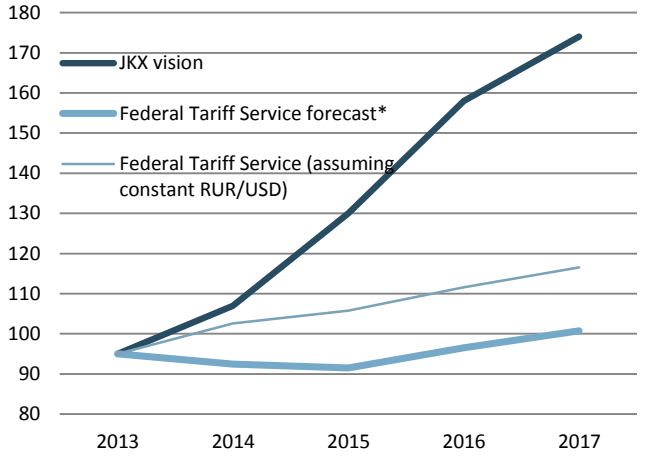
As we estimate in the sections below, the total value of JKX's Russian licenses is USD 78 mln, which is times less than the current level of capital invested in Russia (USD 328 mln) and total CapEx spent for the Russian project thus far (USD 351 mln). This bears a risk for the negative revaluation of JKX's Russian assets in the near future.

Discount to the market price in Russia – profit growth potential

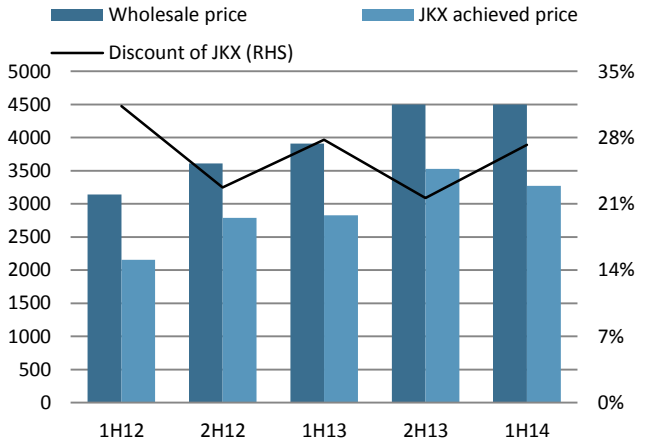
Unlike in Ukraine, where JKX is selling its gas to the market at a 3%-5% discount to the regulated price (refer to page 17), its Russian subsidiaries are selling their gas at a 21%-31% discount to the regulated wholesale price. A reduction in this discount could become a good value driver for JKX's Russian assets.

For valuation purposes, we assume that JKX's achieved price in Russia will change in line with the wholesale price, i.e. the discount will remain unchanged.

JKX gas price change in Russia, USD/tcm*



Prices in Adygea, RUR/tcm, net of VAT



** Assuming an average RUR/USD rate of 32.0x in 2013, 35.5x in 2014 and 37.0x afterwards; and assuming JKX 's gas selling price will change in line with the gas price for industrial consumers in Russia*

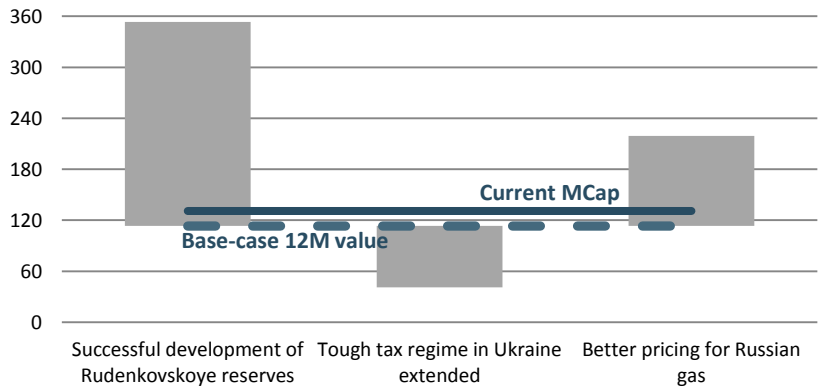
Source: Company data, Russian Federal Tariff Service, Adygregiongaz, Concorde Capital research

JKX valuation summary

Valuation summary

	USD mln	USD/boe of 2P	Per EBITDA '15
Ukrainian assets	131.1	11.2*	2.1
Russian assets	45.6	0.8	4.7
UK costs	-66.3	-	-
Total EV	**110.4**	1.7*	1.7
Net cash, 2014E	2.9		
Equity value	**113.3**		
Current Mcap	130.9		
Implied upside	**-13%**		
Peer median		**8.2**	**5.0****

Equity value range, depending on assumptions, USD mln



We base our JKX target price on a sum-of-the-parts valuation, evaluating separately the operations of the company's two core regions, Ukraine and Russia, using a DCF approach. We further determine JKX's value by accounting for the total costs of its U.K. office, which provides no synergy for the company's operations, in our view.

We are assigning a target MCap for JKX at USD 113.3 mln (USD 0.66/share), which implies a 13% downside. We are assigning a **SELL** recommendation for JKX, keeping also in mind that our value estimate is subject to a downside risk, fixing the interim high tax level for future periods.

The core assumptions and details of the valuation are provided in the next slides.

The core **downside factors for our value** estimate are:

- A possible reduction of the value of JKX's Ukrainian assets if hiked production-based taxes, implemented temporarily for 2H14, will be extended for the future. The loss of value could be up to USD 72 mln, or 64% of the company's fair equity value, we estimate.
- A possible reduction of 2P reserves in Russia due to the postponement of Russian plans to increase wholesale gas prices on local market.

The **core upside factors for our value** estimate are:

- The successful development of its Rudenkovskoye field in Ukraine , which reportedly accounts for 2/3 of Ukrainian 2P reserves, the efficient extractability of which has yet to be proven. If proven to be successful, this asset may add up to USD 240 mln to JKX's value (based on the USD 11.2/boe reserves multiplier derived for JKX's other Ukrainian assets). However at the moment, the likelihood is higher that this asset will not pay off.
- A decrease of the effective discount of JKX's gas price in Russia closer towards the local benchmark, which could bring additional value to the company of up to USD 106 mln, we estimate.
- Some additional upside potential can emerge once the company implements some cost saving measures in its U.K. office, which is eating away more than a third of the company's total value generated beyond the U.K..

On top of that, no changes into Ukrainian tax code till the end of 2014 (implying no painful tax regime will be implemented) could be a powerful catalyst for JKX stock in the near term.

** Excluding Rudenkovskoye reserves; ** EV / EBITDA for 2014*
Source: Company data, Bloomberg, Concorde Capital research

Ukrainian operations modeling – core assumptions

Area of future operations:
We model JKX's future operations based on its official data of 2P reserves and provided drilling plans for its Ukrainian assets. We assume the company will stop producing gas at a deposit as soon as its 2P reserves decline to less than 5% of the level reported as of end-2013.

Novo-Nikolayesvkoye complex (NNC) – we model the extraction of 2P reserves at NNC's existing fields except Rudenkovskoye which, thus far, have failed to prove that hydrocarbons can be economically extracted there.

- We assume all the existing wells will show a 30% p.a. decline rate in their output, based on JKX's performance over the last two years.
- JKX has scheduled drilling of 10 new wells at NNC in 2014-2016, including four wells at in the Rudenkovskoye area. Conservatively, we assume the company will drill two unsuccessful wells at the Rudenkovskoye field and abandon this area.
- We assume each of the six new wells (outside of Rudenkovskoye) will provide a 180 boepd production rate in the first year of operations. The rate of decline for the new wells is assumed to be 30%.

With such a set of assumptions, the 2P reserves of the NNC will be recovered by 97% by the end of 2020.

Elizavetovskoye field (ELIZ) :

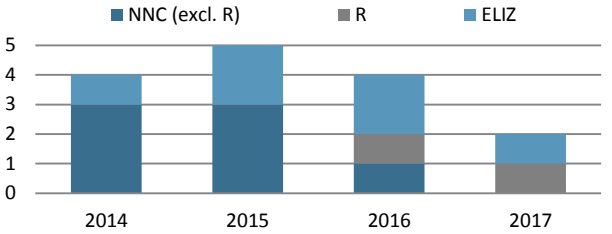
- We assume the company will successfully drill six new wells in 2H14-2016, in line with the plan and the recently demonstrated success rate.
- The wells will show 30% yoy decline in yields in their second year and 20% p.a. decline afterwards, we assume.
- The two newly drilled wells (E-101 and E-102), which showed 1,020 boepd initial output on average, while we expect they will produce 810 boepd, on average, in the first year of their operations.
- The three next wells to be drilled are assumed to provide a 10% smaller initial production rate compared to E-101 and E-102. The rest of the three wells will show a 20% lower initial rate.

With such a set of assumptions, the 2P reserves of the Elizavetovskoye will be exhausted by 96% by the end of 2021.

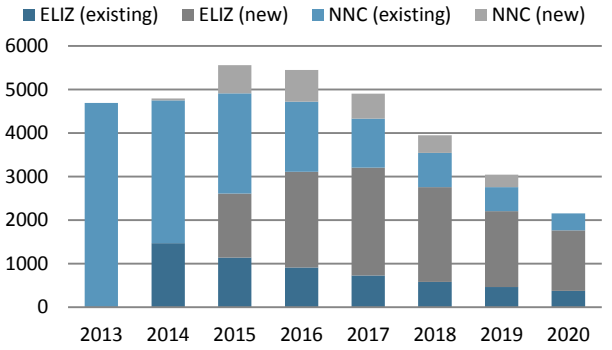
Prices:
The Ukrainian *marginal* gas price is assumed to be USD 11.5/tcf (USD 69/boe), see page 10. We assume JKX will sell its gas at a 3% discount to the marginal price. Prices for condensate and LPG are assumed to be constant at USD 90/bbl and USD 800/t, respectively.

The share of condensate and LPG in in the company's total Ukrainian output mix will decrease, in line with growth of output from its ELIZ deposits, which are poor in condensate (it accounts for just 1% of ELIZ output mix). For this reason, the average achieved price per boe of JKX products sold will be declining from USD 74.4 in 2015 to USD 65.6 in 2021.

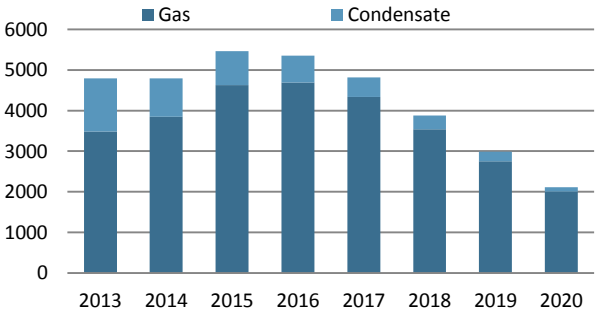
Well drilling outlook. units



Production outlook, boepd



Sales mix, boepd



Source: Company data, Concorde Capital research

Ukrainian operations modeling – core assumptions (cont'd)

Capital expenditures
The company reported its average drilling costs per well at USD 3.1 mln in 2012. With devaluation of the local currency, we expect a 20% decline in USD-based costs per well, thus assuming a USD 2.5 mln CapEx per new well in the future. Other CapEx (recompletion, workover and other works) is assumed to be USD 12 per boe of gas produced in each of the following years. In the last year of operations (2021), CapEx is assumed to be zero.

Production taxes
We assume the interim hike in royalty taxes in Ukraine, valid for 2H14, will be extended till the end of 2015 (refer to page 11). Tax for condensate is assumed to be 40% of its price. This will result in a tax increase from USD 19.0/boe in 2013 to USD 32.5/boe in 2015, and decline to USD 21.0/boe in 2016, due to the relaxed tax regime. Further on, the tax will gradually decline to USD 19.3/boe by 2021, mainly due to a decrease in the share of condensate in its output mix.

Production costs
The company has not provided the direct costs of hydrocarbon production at its various locations worldwide, so we are only roughly estimating its production costs in its core assets, Ukraine and Russia. Direct production costs, as well as SG&A, are one of the smaller cost items for the company's operations. For modeling purposes, we assume that direct costs will be USD 6.5 per boe of natural gas produced in 2015 (in line with estimated costs for the last five years, in UAH terms) and will increase 2% p.a. afterwards.

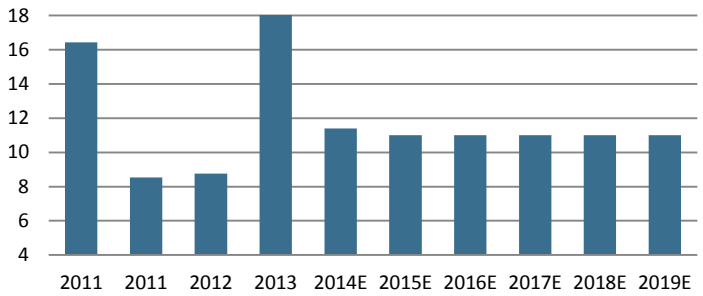
General and administrative costs
We assume the general and administrative costs of its Ukrainian operations will be USD 10 mln in 2015 and will further decrease 2% p.a.

Depreciation, depletion & amortization is assumed to remain proportional to hydrocarbons production and changes in fixed assets over the previous period.

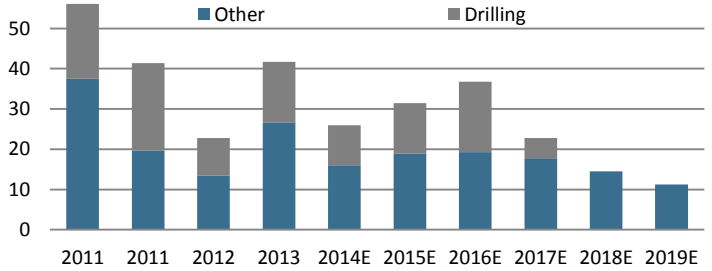
The income tax for its Ukrainian assets is assumed to be 19% for the future periods.

Other assumptions used for DCF modeling purposes:
- Working capital changes are assumed to be zero for the whole forecasting period
- Discount factor: 15% p.a.
- Residual value after mining assets exhaustion: 0
- UAH / USD for the future periods is assumed to be 12.5x

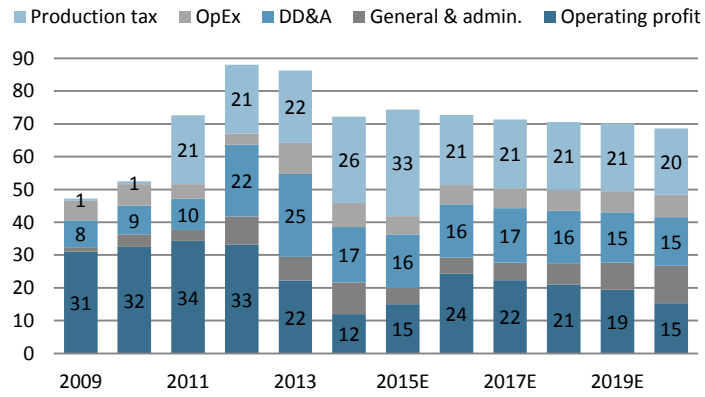
Non-drilling CapEx, USD/boe of gas



Total CapEx, USD mln



Revenue, costs and profit, USD/boe



Source: Company data, Concorde Capital research

Ukrainian assets: Valuation output

DCF valuation output, Ukrainian assets, USD mln

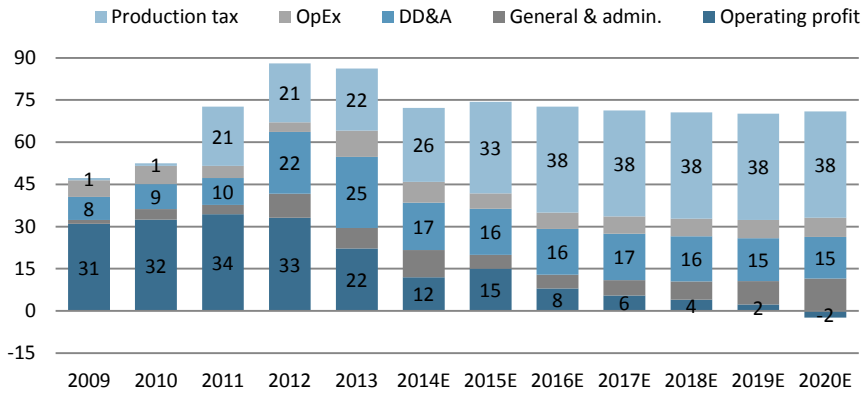
	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Taxed operating profit	16.9	24.7	39.4	32.4	24.5	17.5	9.8	0.9
DD&A	29.5	33.2	32.4	29.7	23.1	17.0	11.7	5.9
CapEx	-26.0	-31.5	-36.8	-22.8	-14.5	-11.3	-8.2	0.0
FCF	**20.5**	**26.4**	**35.0**	**39.3**	**33.1**	**23.2**	**13.2**	**6.8**
Discounted FCF (mid-2015)		**26.4**	**30.4**	**29.7**	**21.8**	**13.3**	**6.6**	**2.9**

Total value of Ukrainian assets, based on the above assumptions, is estimated at USD 131.1 mln as of mid-2015, or USD 11.2 per boe of the last reported 2P reserves*.

Modeling a possibly extended production-based tax hike

If Ukrainian government extends the current production-based tax hike for gas beyond 2015, the total value of JKX's Ukrainian assets would be USD 58.8 mln (USD 5.0 per boe of 2P reserves*), all other things being equal. Clearly, such an outcome would lead to a reassessment of the company's entire strategy regarding Ukraine, so our estimate is very rough.

Revenue, costs and profit, USD/boe: assuming extended production tax hike



** All Ukrainian 2P reserves are net of Rudenkovskoye field*
Source: Company data, Concorde Capital research

Russian operations modeling – core assumptions

Production and reserves development
We assume that JKX's annual production in Russia will be limited by the planned total processing capacity of its gas treatment facility (60 mcf/d, or 10,000 boepd). We forecast the annual production of JKX's Russian fields will be 90% of its gas processing capacity (or 9,000 boepd each year).

The total all-time production in Russia will be limited by the fields' 2P reserves, as they are currently reported. This implies the company's Russian 2P reserves will be exhausted by the end of 2031. For modeling purposes, we explicitly forecast the company's free cash flow till 2022.

Capital expenditures
As there is no sufficient historic period to estimate the sustainable CapEx of its Russian fields, we assume capital expenditures in Russia will gradually increase from USD 8 mln in 2015 to the level of depletion, depreciation and amortization by 2022.

Depreciation, depletion & amortization is assumed to remain proportional to hydrocarbons production and changes in fixed assets from the previous period.

Prices and taxes
We assume gas prices will grow between 2014 and 2017 in line with the recent forecast of the Russian Federal Tariff Service (see page 41), or at a 1.5% CAGR. Afterwards, we assume a 5% p.a. growth rate.

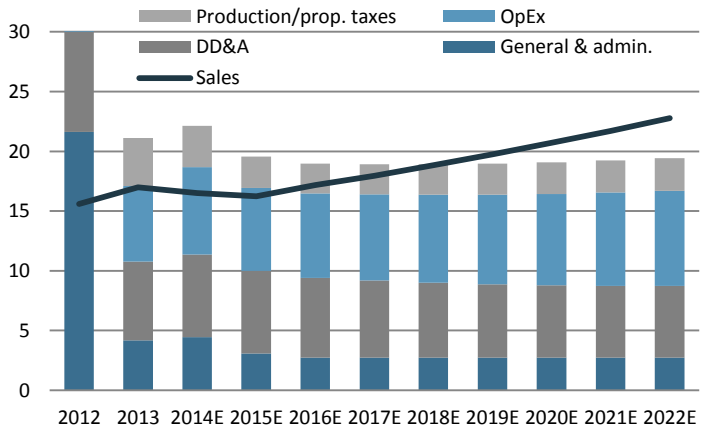
Production taxes in Russia are based on JKX's own forecast: RUR 330/tcm for 2H14-1H15, RUR 340/tcm since 2H15. Using this logic, we forecast production taxes in Russia will grow further at a 3% CAGR. The company is also subject to property tax, which we believe will change (from USD 3.0 mln in 2014) in proportion to the change in its total Russian assets.

Operating costs are assumed to be USD 7.0 per boe of gas produced in 2015, and will increase 2% p.a. afterwards. **G&A** costs are assumed to be at USD 8.3 mln in 2014 and stable afterwards, in USD terms.

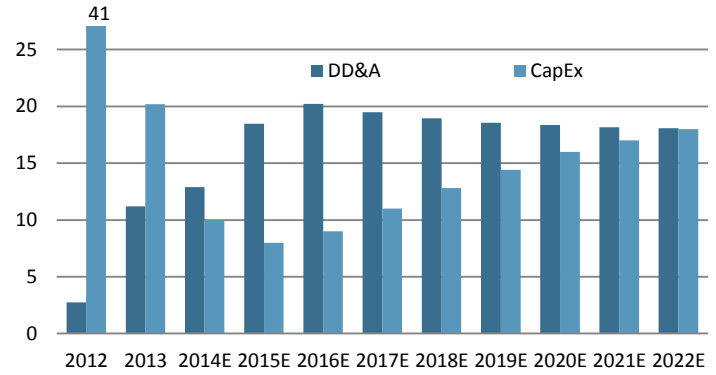
Profit tax is assumed to be 20% in Russia

Other assumptions used for DCF modeling purposes:
- Working capital changes are assumed to be zero for the whole forecasting period
- Discount factor: 15% p.a.
- The Free Cash Flow growth rate in the post-forecasting period, until the reserves are exhausted (2023-2031), is assumed to be 5% p.a.
- Residual value after reserves exhaustion is zero
- RUR/USD for the future periods is assumed to be 37.0x

Revenue & costs, USD/boe



CapEx vs. depreciation, USD mln



Source: Company data, Concorde Capital research

Russian assets: Valuation output

DCF valuation output, Russian assets, USD mln

	2014	2015	2016	2017	2018	2019	2020	2021	2022	Terminal
Taxed operating profit	-10.5	-8.9	-5.5	-2.9	-0.3	1.9	4.0	6.0	8.1	
DD&A	12.9	18.5	20.2	19.5	19.0	18.6	18.4	18.2	18.1	
CapEx	-10.0	-8.0	-9.0	-11.0	-12.8	-14.4	-16.0	-17.0	-18.0	
FCF	**-7.6**	**1.6**	**5.8**	**5.6**	**5.9**	**6.0**	**6.3**	**7.2**	**8.2**	
Discounted FCF (mid-2015)		**1.6**	**5.0**	**4.2**	**3.9**	**3.4**	**3.1**	**3.1**	**3.1**	**18.1**

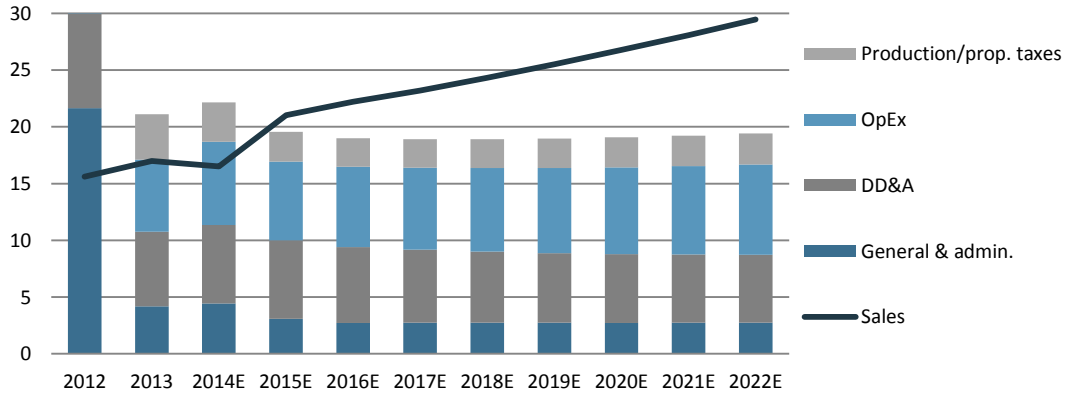
Sum of discounted FCF in 2015-2022: USD 27.5 mln
Sum of discounted FCF in 2023-2031: USD 18.1 mln

We estimate the total value of Russian assets, based on the above assumptions, at USD 45.6 mln as of mid-2015, or USD 0.8 per boe of the last reported 2P reserves.

Modeling improved pricing on the Russian market

If JKX managed to eliminate the discount of its selling price to the Russian wholesale market (which results in 30% appreciation of its selling gas price), the value of its Russian assets would increase to USD 151.5 mln (USD 2.5 per boe of 2P reserves), with everything else being equal.

Revenue & costs, USD/boe: assuming decreased discount on Russian market to 3%



Source: Company data, Concorde Capital research

UK/other assets: Modeling and valuation

UK operations:

The company does not disclose detailed information on operations in UK – all we know is EBITDA and operating losses numbers, as well as costs related to compensations of directors.

Discouraging news is that compensation of directors, which should be performance-based, does not correlate with JKX P&L number – it's always growing, which suggests the company's top management is efficient in assigning the KPIs which can be easily performed, disregarding how much it will cost to the company.

For forecasting purposes, we assume that board compensations will increase 5.0% p.a. in the future (which is slightly below the average growth rate over the last five years), while London-based losses incurred from other costs will stabilize at the level of 2012 (USD 6.0 mln). In 2021, when full exhaustion of Ukrainian deposits is expected, we forecast that other costs will halve and remain flat until the year 2031.

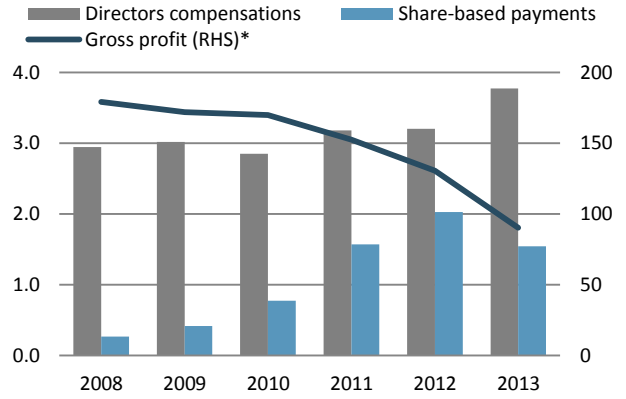
Such set of assumptions (with a discount rate of 15%) **values JKX's London assets at USD -66.3 mln.**

Other operations are ignored, for valuation purposes as their profile and prospects are unclear.

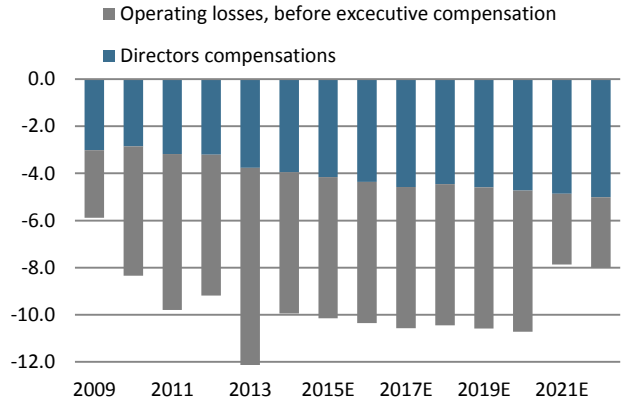
UK valuation, USD mln

	2014	2015	2016	2017	2018	2019	2020	2021	2022	Terminal
Operating losses	-9.9	-10.1	-10.2	-10.3	-10.4	-10.6	-10.7	-7.9	-8.0	
D&A	0.7	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	-9.3	-9.4	-10.2	-10.3	-10.4	-10.6	-10.7	-7.9	-8.0	
Discounted FCF (mid-2015)		**-9.4**	**-8.9**	**-7.8**	**-6.9**	**-6.0**	**-5.3**	**-3.4**	**-3.0**	**-15.6**

Directors costs and gross profit, USD mln



Forecasted London operating losses, USD mln



** Gross profit is defined here as revenue less all the production costs (excluding DD&A) and production based taxes*
Source: Company data, Concorde Capital research

Company focus: Serinus Energy

Serinus Energy: company profile

Serinus Energy (Kulczyk Oil Ventures until June 2013) is an international oil & gas development and production company controlled by Poland's richest businessman, Jan Kulczyk. The company launched its IPO on the Warsaw Stock Exchange in May 2010 to raise USD 99 mln. Last year, it merged with Toronto-listed Winstar Resources to gain interest in Tunisian assets and an additional listing of its shares in Canada.

The company's key producing assets are currently located in Ukraine and Tunisia. It still is struggling to gain some return in Brunei, where it has spent over USD 325 mln, without any success. A possible new cash generating project could be Romania, where the company is initiating exploration in 2014.

Its CapEx activity in Ukraine was suspended in June 2014 due to the proximity of its Ukrainian assets to the military conflict in eastern Ukraine. Incidentally, the company's hot-spot assets are not limited to Ukraine – it also has a suspended project in war-torn Syria.

Investment case

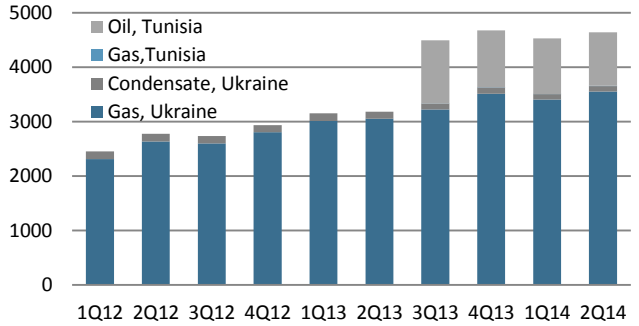
We are initiating coverage of Serinus Energy with a **SELL** recommendation. Our target price of USD 1.71/share implies a 12% downside for the stock. While the company's two operational projects yield a higher value than the current market price of Serinus, all this upside potential is eaten away by the costs of its international offices and top management. We do not expect these costs will decrease in the future, though they might offer a return if the company succeeds with the projects that it has in its portfolio and who are yet to show their hydrocarbons reserve potential.

Even bigger potential for Serinus's downside may be warranted if the Ukrainian parliament makes permanent its temporary hike in gas production tax. This would decrease the value of its Ukrainian assets by 43% (and all assets by 33%), we estimate.

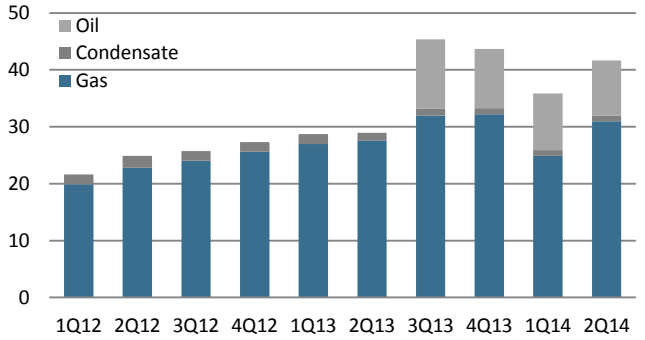
At the same time, the other apparent risk related to Serinus's Ukrainian operations, the escalation of the conflict in the Luhansk region, seems to have had a minor impact on the company's value so far. Only two out of its four currently operational assets in Ukraine are located dangerously close to the war zone, and their loss would cost less than 4% of the company's total value, we estimate.

The core factor that would make us upgrade our value estimate for Serinus is potential success in its new project in Romania. While it's too early to estimate a possible value growth potential there, this project – if the exploration proves successful – can be launched very soon, given the company's current activity in the country.

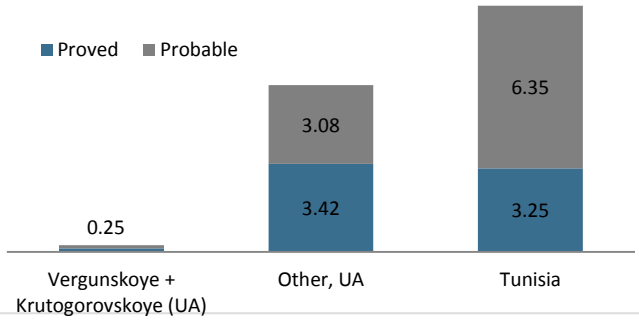
Hydrocarbon sales, boepd*



Revenue, USD mln



2P reserves, end-2013, mln boe*



** Numbers are net to working interest of Serinus*
Source: Company data, Concorde Capital research

Investments and paybacks

Out of the company's many projects in its portfolio, those currently successful are only two: **Ukraine** and **Tunisia**. The assets in these two countries look the most prospective for Serinus and will remain core cash cows for the company in the foreseeable future.

Brunei

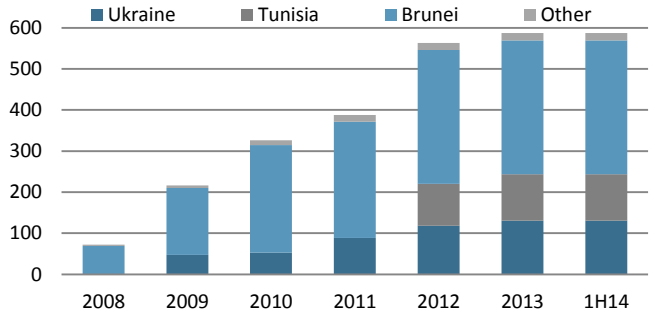
The company's biggest failure is its Brunei project, where it spent more than USD 325 mln for acquisition, exploration and development. The company is writing down all the costs related to the project, while trying to invest more in exploration.

Among the company's other minor projects are exploration licenses in **Syria** and Romania, where it has spent less than USD 10 mln aggregately over the last five years. Its Syrian project has been suspended, as of now, as the country has turned into a hot spot over the last couple of years.

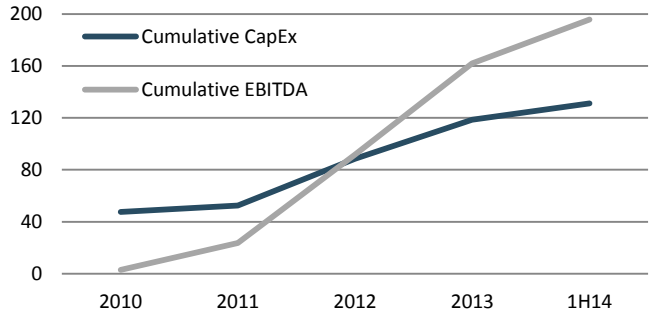
Romanian project

Its Romanian project, Satu Mare (acquired in 2013 together with its Tunisian assets), is at the initial stage of development. For 2014, Serinus has scheduled spending USD 14.8 mln for exploration work, including 3D seismic and drilling of two exploration wells. No reserves have been reported for Romania, thus far. Theoretically, this project could become a third success story for Serinus . Its preliminary results should arrive in late 2014 or early 2015.

Cumulative CapEx, incl. acquisition costs, USD mln

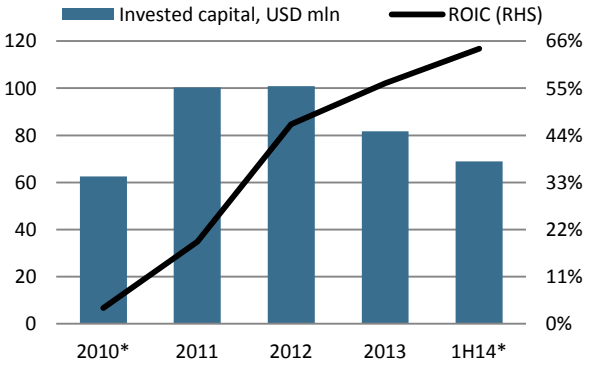


Ukraine: investments and payback, USD mln

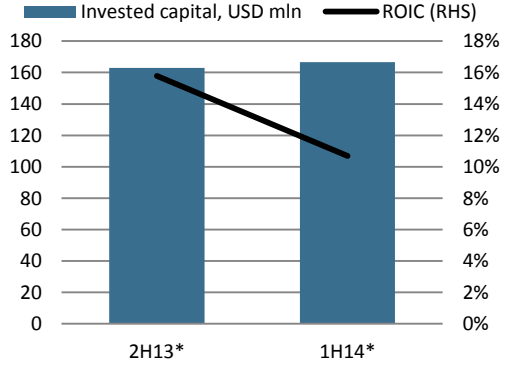


Invested capital and return **:

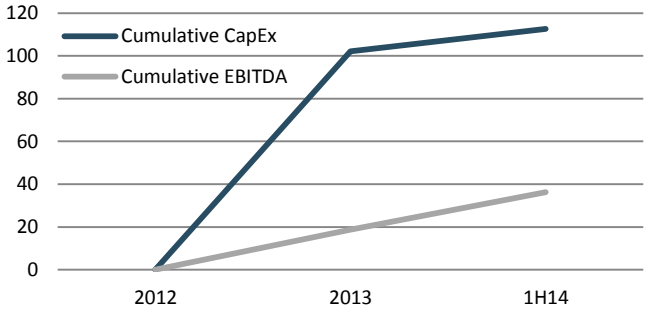
Ukraine



Tunisia



Tunisia: investments and payback, USD mln



** Annualized return; ** Invested capital (IC) is defined as total assets less current liabilities; ROIC (return on IC) is defined as ratio of PBIT to average IC*
Source: Company data, Concorde Capital research

Ukrainian asset (KUB-Gaz)

Serinus has a 70% stake in the Ukrainian company KUB-Gaz, purchased in June 2010. KUB-Gaz operates five gas assets in the Luhansk region in easternmost Ukraine. Serinus shares all the costs and profits related to KUB-Gaz on a pro-rata basis with the other shareholder, Toronto-listed CUB-Energy. The latter's management claims to have operating control over the Ukrainian asset and considers Serinus a portfolio investor.

Clearly, the most worrying thing about KUB-Gaz is its location. The southern part of the Luhansk region has been occupied by the Russian army and pro-Russian terrorists since May 2014. The good news is that the company's major assets are located far from the conflict zone. Unfortunately, this does not guarantee that their location won't be captured by Russian army any time in the near future.

Thus far, with all the peace attempts made by the Ukrainian president, the risk of Russia's occupation of the company's main fields, located in the westernmost part of the Luhansk region, looks low. At the same time, the company's two assets located near the city of Luhansk look extremely risky right now.

Its most risky assets are the Vergunskoye (**V**) and Krutogorovskoye (**K**) production licenses. Both fields are currently on the border of areas controlled by terrorists and the Ukrainian government, which makes their future undefined and their operations extremely risky. The good news is these two fields are considered by the company as the least prospective and they provided only 3.3% of KUB-Gaz's total output in 2013. In Serinus's history (since mid-2010), only one well has been drilled on these two locations , and the company's latest reserve report assumes no new drilling there. The company operates five wells on these two areas.

Much less risky assets, by their location, are:

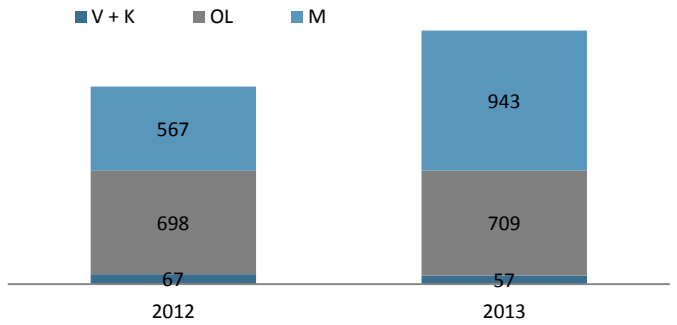
Olgovskoye (OL) production area – the most developed asset of KUB-Gaz. The company operates ten wells on the field, most of which have been commissioned in 2010-2013, and two more recently drilled are candidates for stimulation. The wells drilled on the field are relatively shallow (most of them are 1800m-3300m in depth) and are providing relatively low initial gas yields, which have declined rather quickly (up to 40% in the first year and about 30% afterwards).

Makeevskoye (M) production area – the biggest asset in terms of production and 2P reserves. Serinus bough the asset in 2010 with two operational wells, and since then successfully drilled three more wells (out of a total of five wells drilled), which were the core output driver of KUB-Gaz for 2012-2014.

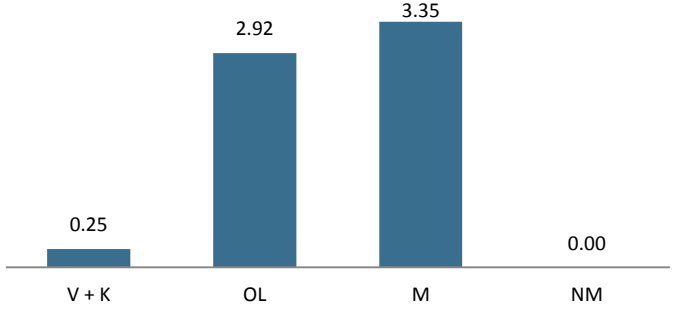
North-Makeevskoye (NM) exploration area – the least developed asset of KUB-Gaz. The three wells drilled in the area in 2012-2013 were not successful, and drilling on the fourth one (the NM-4 well) was stopped in June 2014 after the military escalation in the Luhansk region. The field has **no 2P reserves** and is naturally ignored by us for the purpose of modeling.

KUB-Gaz assets on the Ukrainian map*

KUB-Gaz production by assets, '000 boe



KUB-Gaz - 2P reserves, mln boe (net to Serinus)



** Area under Ukrainian control as of Sept. 21, 2014*
Source: Company data, National Security and Defense Council, Concorde Capital research

Ukrainian operations

Gas production up 6x in four years

Serinus's Ukrainian assets proved rather successful, with the production of natural gas having increased six times over the last four years, primary due to the development of its new areas, Makeevskoye (**M**) and Olgovskoye (**OL**).

Its Makeevskoye license proved to be especially successful, with three out of five drilled wells showing initial gas flow rates of more than 4.1 mcf/d (680 boepd, gross). At the same time, its North Makeevskoye (**NM**) exploration license produced no successful well. In 2013, the company also successfully stimulated two wells on its Olgovskoye field, enabling it to improve gas output in the latest quarter of the year.

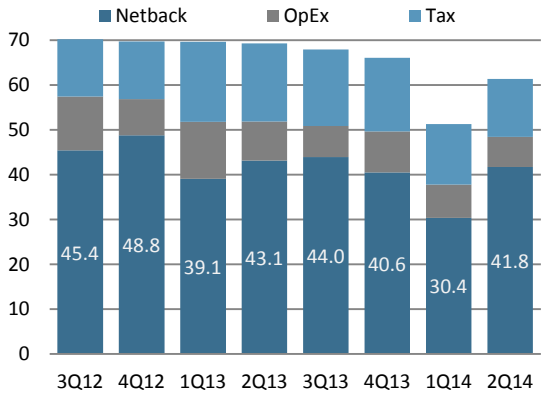
On its Krutogorovskoye (**K**) and Vergunskoye (**V**) licenses, the company has demonstrated a declining output rate, with just a single well having been drilled.

Pricing, costs and netback

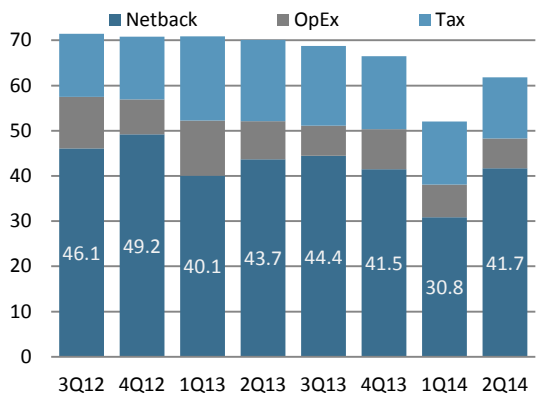
Serinus enjoys the lower gas price of its peers in Ukraine – the average historical discount to the benchmark marginal price in Ukraine was 5-7%, vs. 2%-5% for peers. Moreover, due to the low content of condensate in KUB-Gaz's hydrocarbon mix, the company's average price per boe was historically 7%-10% below the levels reported by peers.

On the positive side, Serinus usually reports no general and administrative costs at its Ukrainian asset, which makes its EBITDA per boe comparable to peers.

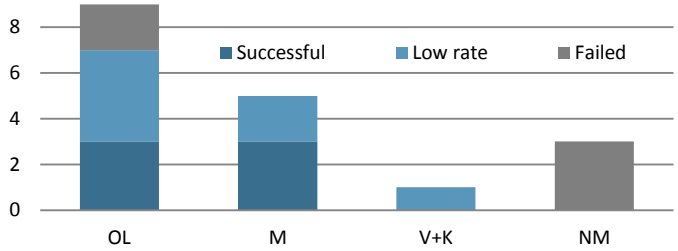
Gas P&L (gross), USD/boe



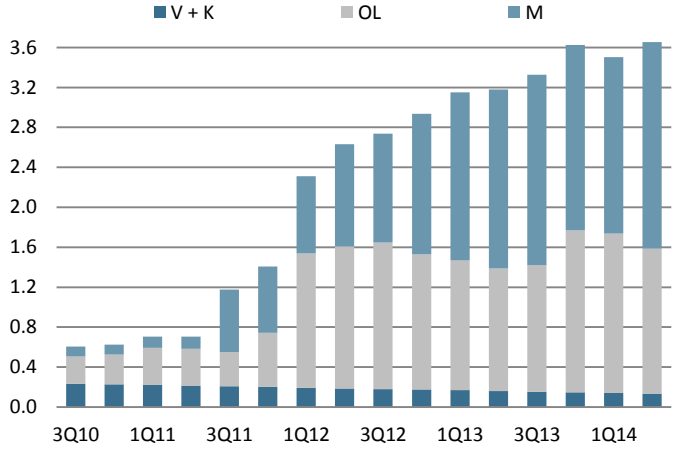
Gas & condensate P&L (gross), USD/boe



Results of KUB-Gaz new well drilling by license, 2010-1H14



Production by license (net to Serinus), ,000 boepd



Source: Company data, Concorde Capital research

Tunisian assets

Serinus Energy emerged in 2013 as the result of a merger of Kulzcyk Oil Ventures (the owner of Ukrainian and Brunei assets with KUB-Gaz) and Winstar Resources (the owner of the Tunisian and Romanian assets) in June 2013. Following the deal, which cost USD 99.5 mln to the shareholders of Kulczyk Oil, Serinus got a 100% stake in four and a 45% stake in a fifth concession area in Tunisia. The assets are focused on oil production, mostly for export.

The Tunisian licenses of Serinus include:

Chouech es Saida (**CS**) - the biggest asset by output (66% of net Tunisian production in 2Q14) operating seven oil-producing and two gas-producing wells. The company's plan envisions one new well drilling in 2015 and the possibility of drilling two more in the following years. This year, Serinus concentrated on the workover of three wells, which wasn't successful as total output from the field fell 25% over the last three quarters.

Ech Chouech (**EC**) – an area with a single operational well producing oil and gas. Serinus plans to work over a couple of earlier abandoned wells at this site and also may drill one more.

Sabria (**SB**) – the biggest in terms of 2P reserves of all Serinus's assets. It's the only Tunisian license where Serinus has a 45% working interest (the rest is owned by Tunisian state holding ETAP). Unlike other assets in Tunisia, this license has no connection to an oil pipeline or port terminal – the produced oil is transported to a pipeline located roughly 100 km east of the deposit.

Sabria is the main focus in Serinus's Tunisian asset development plans. The company aims to drill one well by October 2014 and spud a new one afterwards. The total plan regarding this field is to drill four new wells and try to recomplete another.

Sanghar or Sanrhar (**SN**) – a small filed consisting of a single oil-bearing well, with no plans for more.

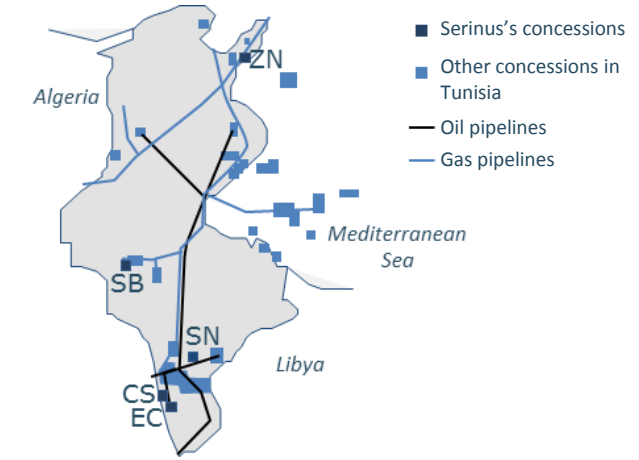
Zinnia (**ZN**) – currently non-producing area consisting of one failed well and one abandoned well that Serinus is going to restart in 2015, with no other drilling plans there.

The company's Tunisian assets vary not only in terms of their hydrocarbon mix, but also in their concession terms, including the taxation rate applied and relationship with state holding ETAP.

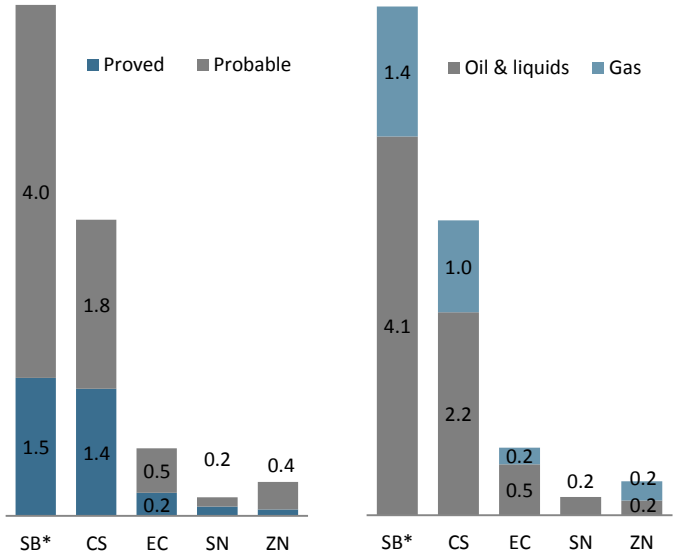
Summary of core specifics by concession area

	Royalty tax rate	Income tax rate	Relations with ETAP	Domestic market obligation**	Oil transportation costs, USD/bbl
SB	10% - 15%	50% - 75%	ETAP holds 55%	Yes	2.60
ZN	2%-15%	50% -75%	-	Yes	7.00
CS	15.0%	35%	ETAP may buy 50% after cumulative sales >6.5mln bbl (1.3 mln bbl to go)	-	1.80
EC	15.0%	35%	-	-	1.80
SN	12.5%	55%	-	-	3.75

Serinus on Tunisian map



Tunisian 2P reserves breakdown, mln boe



** For Sabria (SB) - numbers net to Serinus (based on its 45% working interest); ** Obligation to sell 20% of its oil on the domestic market at a 10% discount to export price. Source: Company data, ETAP, Concorde Capital research*

Tunisian operations

Output declining, thus far

With no new wells introduced in Tunisia since Serinus's entrance (it only introduced one small well at the Sanghar filed), its output of oil and gas is declining there each quarter.

The company's near-term plan foresees drilling one new well at its Sabria concession by October 2014, which should improve the company's Tunisian output, if successful. The two successful wells to be drilled in Sabria should more than double by 2015 the company's output from the license, according to Serinus's plan.

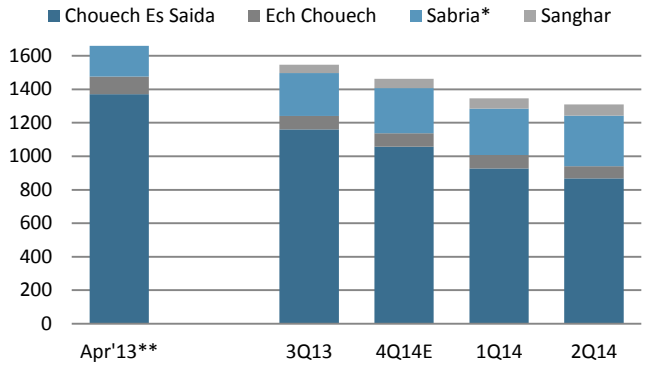
Low royalty – high profit tax

The core specifics of Serinus's Tunisian operations is an individual approach to taxation in each license area. As can be seen on the previous slide, each concession area is subject to a specific royalty tax and profit tax, which should be much higher than the royalty. The peculiarity of some Tunisian fields is that their tax rates increase as soon as the deposit matures (the tax rate depends on the ratio of accumulated net revenue from the field to accumulated total costs (CapEx and OpEx) spent on a field.

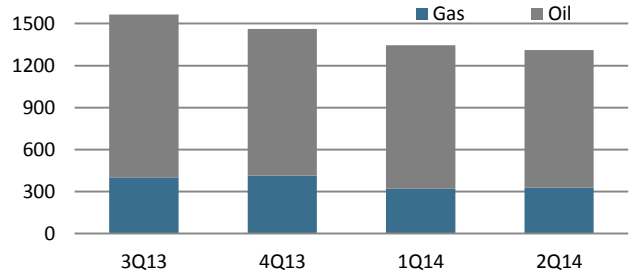
Thus far, the effective income tax rate for Serinus ranged from 37% in 2H13 to 38% in 1H14, but given that oil production at its Sabria filed (taxed 50% currently) will increase already this year, the effective income tax rate should increase in 2H14 and 2015 significantly.

In 2Q14, the company's operating expenses in Tunisia, per boe, jumped 1.5x qoq, which the company attributes to higher staff costs.

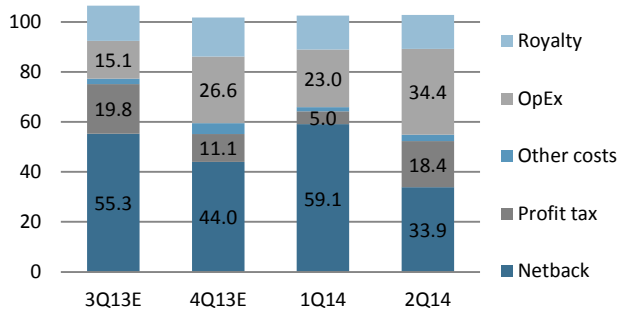
Hydrocarbon output by concession, boepd



Output by product, boepd



Sales and cash netback, USD/boe



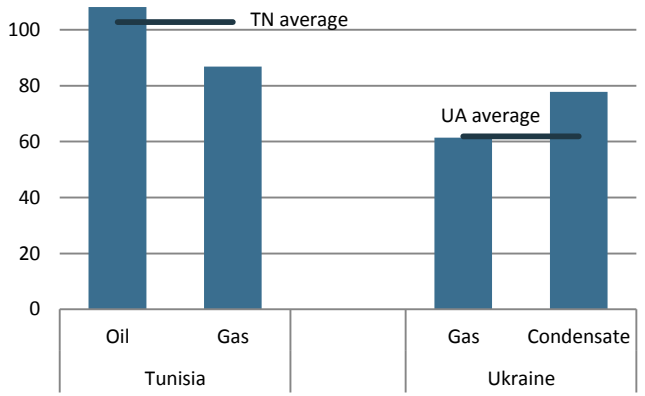
** For Sabria - numbers net to Serinus (based on its 45% working interest); ** Before the acquisition of Winstar by Serinus*
Source: Company data, ETAP, Concorde Capital research

Tunisia vs. Ukraine: higher prices, netback offset by bigger CapEx

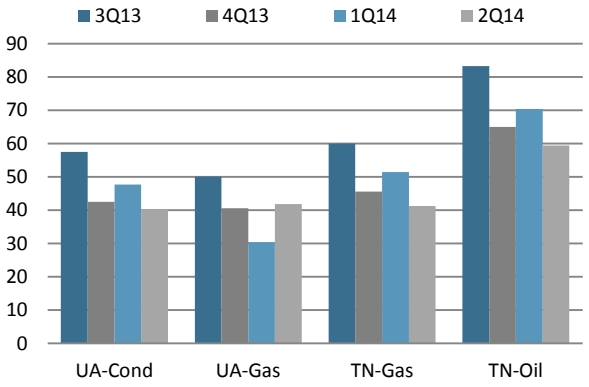
In general, Serinus's Ukrainian and Tunisian assets looks comparable in terms of their cash flow generation potential:

- Its Tunisian assets provide much more valuable product mix and enjoy better prices of comparable hydrocarbons, to generate higher revenue per boe sold.
- Production costs at its Ukrainian assets, per boe, are much smaller
- While current royalty taxes paid were comparable for both countries in 1H14, in the next reporting period Ukrainian royalties will increase due to recent legislative changes. The royalties of Tunisian assets are likely to rise slightly in the mid-term, in line with the maturing of Serinus's most active development license, Sabria.
- At the same time, profit taxes, which will at least be stable (or even declining) in Ukraine, will increase for Serinus's Tunisian assets, as the current concession agreements suggest.
- Better pricing will enable the Tunisian operations to offer higher cash netback per unit of hydrocarbons sold.
- At the same time, Ukrainian operations are less capital-intensive. The average cost to drill a new well in Ukraine is about USD 2 mln, while in Tunisia it costs more than USD 14 mln. For this reason, currently the free cash flow per boe from Serinus's Ukrainian operations are higher than from its Tunisian operations. In the mid-term, both cash flows should be comparable.
- There is a good chance that Serinus's Tunisian project will become at least as efficient for the company as the Ukrainian one.

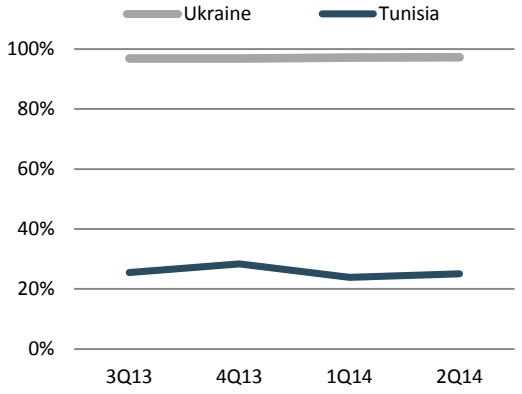
Prices in 2Q14, USD/boe



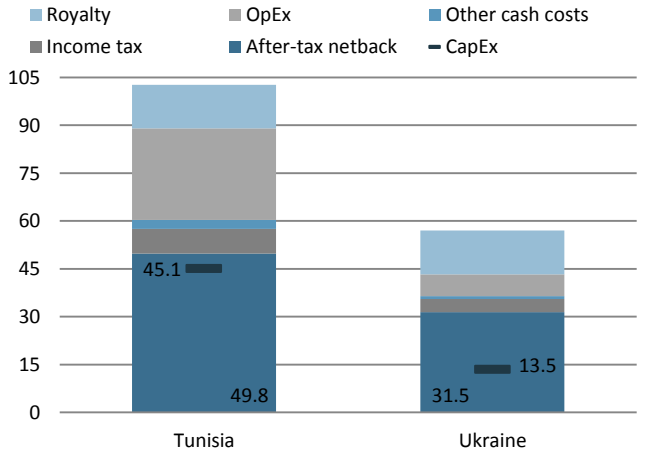
Operating netback (after royalty and OpEx), USD/boe



Share of gas in output mix



Revenues, netback and CapEx in 1H14, USD/boe



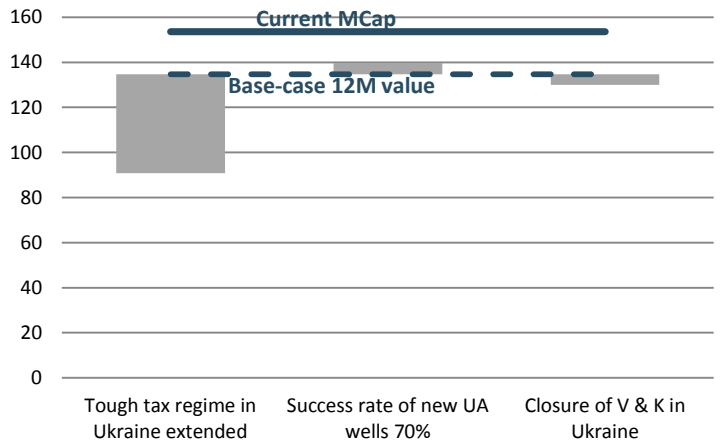
Source: Company data, Concorde Capital research

Serinus valuation summary

Valuation summary

	USD mln	USD/boe of 2P	Per EBITDA '15
Ukrainian assets	100.2	14.8	4.6
Tunisian assets	129.4	13.1	3.0
Corporate costs	-79.0		
Total EV	**150.6**	**9.0**	**2.2**
Net debt, end-2014	16.0		
Equity value	**134.6**		
Current MCap	153.5		
Implied upside	**-12%**		
Peer median		**8.2**	**5.0***

Equity value range, depending on assumptions, USD mln



We base our target price for Serinus Energy on a sum-of-the-parts valuation, evaluating separately the operations of the company's two core regions, Ukraine and Tunisia, using a DCF approach. We further determine Serinus's value by accounting for the negative discounted value of its corporate segment.

We are assigning a target MCap for Serinus at USD 134.6 mln (USD 1.71/share), which implies a 12% downside. We are assigning a **SELL** recommendation for the company's stock.

As can be concluded from the table on the left, the core value-killing factor at the moment is its corporate operations, which are eating away at about a third of the value contributed by the company's producing assets. Unlike the case of JKX, where we see a core value increase potential in the decrease of its head office costs, in the case of Serinus, it seems that only new projects can boost the company's value to decrease the negative weight of its offices.

The core assumptions and details of the valuation are provided in the next slides.

The core **downside factors for our value** estimate are:

- A possible reduction of the value of its Ukrainian assets if hiked production-based taxes, implemented temporarily for 2H14, will be extended into the future. The loss of value could be up to USD 44 mln, or 33% of the company's fair equity value, we estimate.
- A suspension of Serinus's operations at its Vergunskoye (V) and Krutogorovkoye (K) licenses, which are located very close to the occupied territory of Donbas. The effect of these two fields on Serinus's value is minimal: about USD 4.6 mln

The **core upside factor for our value** estimate will be the successful initiation of new international projects that the company is trying to develop. This may include:

- Romania, where Serinus is scheduled to drill two exploration wells in 2014 (neither costs, nor potential benefits are accounted for in our modeling);
- Brunei, where the company spent a lot of effort, time and money.

** EV / EBITDA for 2014*
Source: Company data, Bloomberg, Concorde Capital research

Ukrainian operations modeling – core assumptions

Area of future operations: referring to the reserves evaluation report

We model Serinus's future operations in Ukraine based on its official report of 2P reserves and provided drilling plans for its Ukrainian assets. This task is easier for Serinus than for its Ukraine-focused peers, as the company has made public a reserves report containing its detailed plans to drill and produce gas in Ukraine.

Given the risky location of Serinus's two licenses, we assume no new wells and no workovers will be done at its Vergunskoye (**V**) and Krutogorovskoye (**K**) fields. Basically, this assumption does not differ much from the company's plan to drill a single well there.

For valuation purposes, we are also ignoring the company's North Makeevskoye (**NM**) deposit, which failed to provide any economically extractable products from the drilled three wells. The company has initiated drilling of its fourth well, which might be finished by the end of this year. The results of its testing should clarify the prospects of this license.

For modeling the development of the **Makeeveskoye** (**M**) and **Olgovskoye** (**OL**) fields, we use the company's output forecasts provided in the reserves report in the following way:

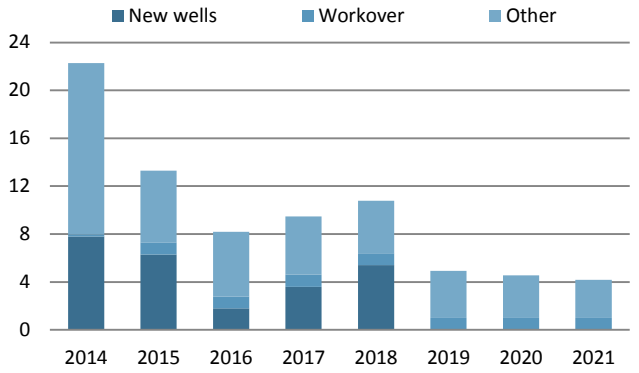
- We take for granted Serinus's extraction plan from existing wells (proven developed reserves) and
- Assume other planned wells (containing proven and probable undeveloped reserves) will perform at 60% of the company's production plan, assuming the success rate of the new wells at these two fields will be 60%. This is sort of a conservative assumption, given that historical success rate for these two fields has been two-thirds of wells.
- We also account for a drilling program delay that happened in 2014 to adjust Serinus's plans accordingly. In particular, we are assuming the three next wells, M-17, M-22 and M-15, will produce at a half-year delay to the plan.

With such a set of assumptions, the company's gross 2P reserves at its **OL** and **M** fields will be exhausted by 90% by the end of 2033. We explicitly forecast operations till 2023.

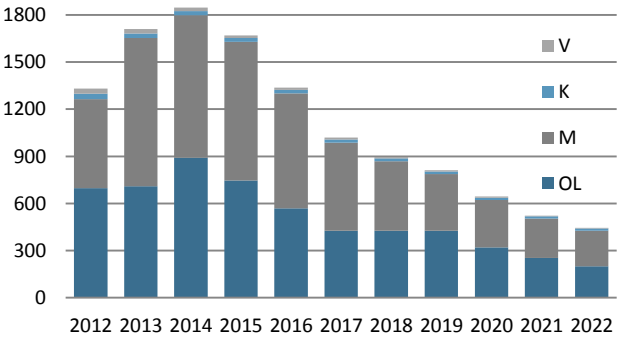
CapEx

Capital costs per new wells are assumed to be USD 2.0 mln in 2014 (in line with the company's outlook) and then decline to USD 1.8 mln/well due to devaluation of the local currency. The well drilling schedule will broadly correspond to the company's outlook provided in its recent reserves report (three new ones at **M** in 2015-2016 and six new ones at **OL** during 2016-2018). We assume workover costs to be at the level of USD 1 mln p.a. for the future. Other CapEx is assumed to be USD 6 mln in 2015 and to decline 10% p.a. in the future.

CapEx schedule (gross), USD mln



Hydrocarbon output outlook (net) ,000 boe



Source: Company data, Concorde Capital research

Ukrainian operations modeling – core assumptions (cont'd)

Prices:
The Ukrainian marginal gas price is assumed to be USD 11.5/tcf (USD 69/boe), see page 10. We assume Serinus will sell its gas at a 6% discount to the marginal price, as its experience suggests. Prices for condensate are assumed to be constant at USD 85/boe.

The share of condensate in the company's total Ukrainian output mix will be constant at 2.4%, as recorded currently. These assumptions result in a constant future price of KUB-Gaz's unit of output at USD 65.3/boe.

Production taxes
We assume the interim hike in royalty taxes for gas production in Ukraine, valid for 2H14, will be extended till the end of 2015 (refer to page 11) and the tax rate will come back to 28% (15.4% for new wells for the first two) in 2016. The effective royalty for condensate is assumed to remain at 40% of its sale price.

Production costs
We forecast operating costs to be USD 6.5 per boe of natural gas produced in 2014, based on the recent reports and outlook. In 2015, we assume they will decrease to USD 6.3/boe of gas due to local currency devaluation and will increase 2% p.a. afterwards.

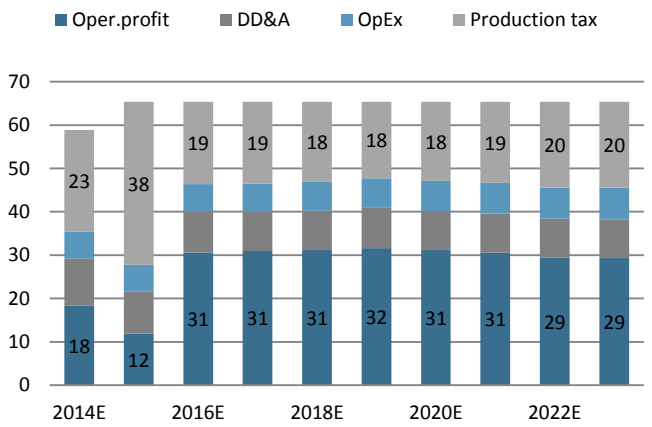
General and administrative costs for the assets are assumed to be zero.

Depreciation, depletion & amortization is assumed to remain proportional to hydrocarbons production and changes in fixed assets over the previous period.

The income tax for its Ukrainian assets is assumed to be 19% for future periods.

Other assumptions used for DCF modeling purposes:
- Working capital changes are assumed to be zero for the whole forecasting period.
- Discount factor: 15% p.a.
- Last year of operations: 2033
- Free cash flow growth rate in 2024-2033: -2% p.a.
- UAH / USD for the future periods is assumed to be 12.5x

P&L items, USD/boe



Source: Company data, Concorde Capital research

Ukrainian assets: Valuation output

DCF valuation output, Ukrainian assets (KUB-Gaz), USD mln

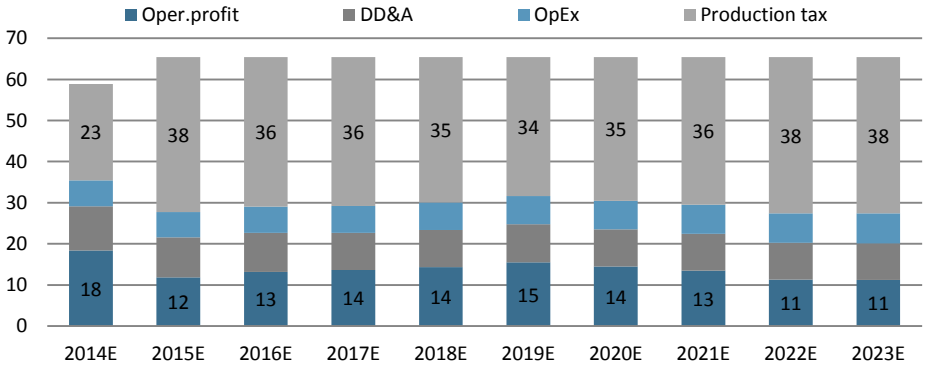
	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	Terminal
Taxed operating profit	28.7	17.7	34.7	27.1	24.2	22.4	17.9	14.6	12.2	10.6	
DD&A	20.8	16.3	12.6	9.2	8.1	7.6	5.8	4.7	4.0	3.4	
CapEx	-22.3	-13.3	-8.2	-9.5	-10.8	-4.9	-4.5	-4.2	-3.9	-3.6	
FCF	**27.3**	**20.6**	**39.1**	**26.8**	**21.6**	**25.0**	**19.1**	**15.1**	**12.3**	**10.4**	
Discounted FCF (mid-2015)		**20.6**	**34.0**	**20.3**	**14.2**	**14.3**	**9.5**	**6.5**	**4.6**	**3.4**	**15.7**

The total value of Ukrainian KUB-Gaz, based on the above assumptions, is estimated at USD 143.2 mln. Based on Serinus's 70% working interest, the value of its Ukrainian asset is estimated at USD 100.2 mln, or USD 14.8 per boe of the last reported 2P reserves.

Modeling a possibly extended production-based tax hike

If the Ukrainian government extends the current production-based tax hike for gas beyond 2015, the total value of Serinus's Ukrainian assets (net to its working interest) would be USD 57.3 mln (USD 8.5 per boe of 2P reserves), all other things being equal. Clearly, such an outcome would lead to a reassessment of the company's entire strategy regarding Ukraine, so our estimate is rough.

Revenue, costs and profit, USD/boe: assuming extended production tax hike



Modeling stoppage of assets near Luhansk

As we highlighted above, two Serinus licenses (V and K) are extracting natural gas very close to the war-prone occupied territory of the Luhansk region. If we assume these two licenses will not provide any gas in the future, the value of KUB-Gaz, net to Serinus, will decrease to USD 96.5 mln, or just 3.7%.

Modeling better success rate for KUB-Gaz's new wells

We assume that only 60% of new wells will be successful for Serinus in Ukraine in the future, which might be too conservative. Changing the success rate assumption to 70% would produce a fair value of KUB-Gaz, net to Serinus, as USD 104.3 mln, or just 4.1% above our base-case estimate.

Comparison to Serinus's estimates of KUB-Gaz value

According to Serinus Energy's reserve evaluation report, the NPV of its Ukrainian assets (net to 70% of its working interest), based on 15% discount rate assumptions, are :

- USD 99 mln, based on the assumption of 1P reserves development and
- USD 168 mln, based on the assumption of development of all its 2P reserves. This is a 68% higher estimate compared to our derived value. The core difference in our and Serinus's assumptions is capital costs (we assume higher) success rate of new wells (we assume 60%) and our updated assumptions on gas production taxes in Ukraine.

Source: Company data, Concorde Capital research

Tunisian and other assets – valuation

Tunisian projects

We are **relying solely on the company's reserve evaluation report** to estimate the value of Serinus's Tunisian exposure, given our limited understanding of the Tunisian oil and gas market and the lack of a long-enough track record of the company operating in Tunisia.

The company estimates the NPV of its Tunisian reserves (based on a 15% discount rate) at:
USD 69.4 mln – based on the assumption of full development of its proved reserves
USD 159.4 mln – based on the assumption of full development of its 2P reserves, implying that additional value provided by the development of probable reserves is USD 100 mln .

Using the assumption that the success rate in extracting the company's probable reserves would be 60%, **we derive our estimate of probability-weighted NPV for Tunisian assets at USD 129.4 mln (USD 12.1 per boe of 2P reserves).**

Other projects are currently ignored by us for valuation purposes, given the lack of information regarding their future cash flows and hydrocarbon reserves.

Modeling and valuation of corporate costs

Similar to JKX, the central and representative offices of Serinus Energy are pure cost centers that account for an average annual decrease in operating profit by about USD 15-18 mln, including USD 1-4 mln being spent for transactions annually. Serinus has too many offices worldwide, including Warsaw, Calgary and Dubai, which do not look to add value. The good news is that the company's corporate costs are nearly non-increasing in time, even though the company has significantly increased its asset base last year.

Assumptions for future costs

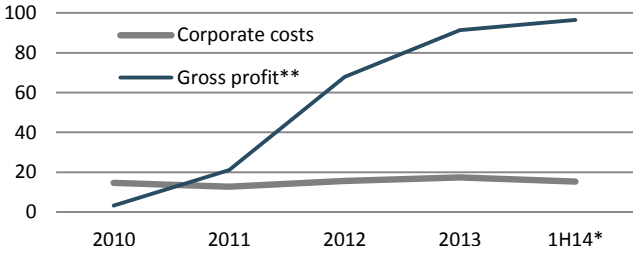
- For valuation purposes, we assume no transaction costs and no costs related to stock-based compensation in the future,
- We forecast that key management costs (USD 3.6 mln in 2013) will increase 4% p.a., or in line with the growth over 2010-2013.
- The remaining costs (USD 6.4 mln in 2013) are assumed to stable in the future.
- The discount rate for future cash outflows related to corporate costs is assumed to be 15%
- The costs are forecasted until 2033, when Serinus is going to halt its Ukrainian operations, based on our estimates.

This set of assumptions yields a **negative NPV of Serinus's international and head offices of USD 79 mln.**

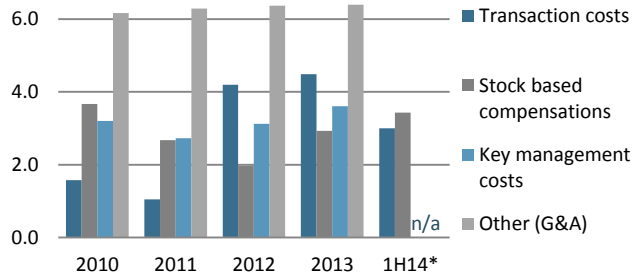
Valuation summary, Tunisian assets, USD mln

Discount rate	Proved NPV	Probable NPV	Risk-weighted NPV (100% proved + 60% probable)
10%	77.7	129.8	
15%	**69.4**	**100.0**	**129.4**
20%	62.7	80.1	

Corporate costs and gross profit, USD mln*



Structure of corporate costs, USD mln



** 1H14 – annualized; ** Gross profit is defined as revenue net of production taxes and production costs*
Source: Company data, Concorde Capital research

Appendix. Terms and abbreviations

Abbreviations

boe – barrel of oil equivalent
bbl - barrel
boepd (boe/d) - barrel of oil equivalent per day
cf –cubic foot
tcf (mcf) – thousand (million) of cubic feet
tcf/d (mcf/d) - thousand (million) of cubic feet per day
cm – cubic meter
tcm (mcm, bcm) – thousand (million, billion) of cubic meters

UA - Ukraine
TN - Tunisia
RU - Russia
BY - Belarus
HU - Hungary
PL - Poland
RO - Romania
SK - Slovakia

Industry-specific terms

1P (proven, or proved) reserves – the amount of hydrocarbon resources that can be recovered (technically and economically) from deposits with a high degree of certainty, usually 90%.

Probable reserves – additional reserves that are less certain to be recovered (about 50% likelihood).

2P reserves = proven and probable reserves

Conversion factors used by companies

1 boe = 6 tcf of gas = 169.8 cm of gas (for Regal, 1 boe = 159.0 cm of gas)
1 boe = 1 bbl of oil or condensate
1,000 cm of gas = tcm of gas = 35,315 tcf of gas = 5.9 boe
1 cm of condensate = 6.1 boe (for Regal)
1 cm of LPG = 4.5 boe (for Regal)

Source: Company data, Concorde Capital research

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