

Dragon Oil

Oil & Gas

HI08 Review: Value very much intact

Closing Price: £3.27

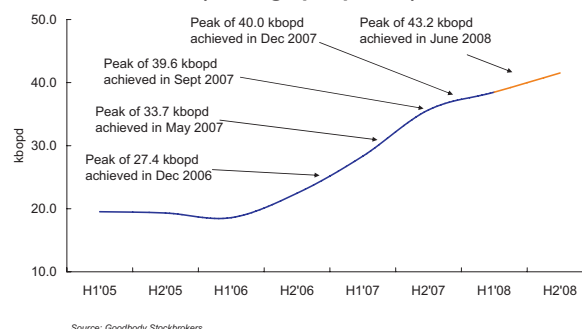
Price Target: £5.80

BUY

- H108 Outcome.** While at 'first glance' the headline data in Dragon's H108 results suggested a shortfall of 9.1% relative to our sales expectation, which derived from guidance in terms of H1 production and the realised price, an explanation lay in a carryover of the overlift at the end of 2007. A consequence of that carryover was that while the DDA charge (\$8.8/bbl) was broadly in line with our estimates, H1 CoS was lower, though when the overlift adjustment was stripped out, production costs actually increased (\$5.1/bbl). Aside from the above: (i) admin charges were lower; (ii) capex was in line, though guidance suggested that it will increase in H2 and into 2009; and (iii) net cash increased by \$110m from December to \$659m despite H1 capex of \$154m.
- Forecast adjustments.** Adjustments to our near term forecasts reflect: (i) the H1 sales and Cost of Sales outcome; (ii) lower admin charges; (iii) a further increase in our near term capex projections; and (iv) a slight reduction in our underlying oil price assumption for H208 from \$115/bbl to \$110/bbl in recognition of the recent correction in crude prices. The net impact is a 3% reduction in FY08 adjusted EPS to 99.4c, but minimal variation to our FY09 forecast of 103.5c.
- Valuation.** We have run the capex increase through the model out to 2025 (steady state capex now of \$200m), but as that increase is recoverable and our long term oil price projection of \$75/bbl is unchanged, the net effect is minimal. Employing our FY09 £/\$ rate of 1.92, rather than our FY08 estimate of 1.99, however, raises total NAV to 527.7p from 511.9p previously, but still looks conservative given a current spot rate of 1.85. Applying a 10% premium to total NAV raises our price target from 565p to 580p. Our view on Dragon is unchanged. We continue to see value at current levels as well as the potential for organic growth, given the size of the reserve base (651 mbo 2P W.I.) and the fact that by our estimate c.40% of Dragon's reserves will remain in the ground post 2025. Efforts to extract that potential continue, with tenders out to secure up to four new rigs, and the possibility of a fourth rig on a short term lease next year. The pending deployment of a third company-owned rig in 2009 underpins our FY09 gross production forecast of 44.0 kbopd, while at the same time efforts continue to commercialise its considerable stranded gas resource (3.5tcf). BUY.

Mkt Cap \$3,219m				
Financial Summary (\$m)				
Year Ending	Dec-07	Dec-08	Dec-09f	Dec-10f
Sales	596.6	827.5	901.5	837.0
Operating Profit	365.1	616.2	632.5	528.3
Amortisation	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0
Associates / JV	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0
EBIT	365.1	616.2	632.5	528.3
Net Interest	19.2	-65.2	36.1	47.8
PBT	384.3	551.1	668.6	576.1
Tax	-80.3	-110.2	-133.7	-115.2
Attributable Profit	303.9	440.9	534.9	460.9
EBITDAe	467.0	748.9	784.9	707.0
Net Debt	-548.6	-764.9	-1,049.7	-1,349.7
Per share Analysis (c)				
Adjusted EPS	59.2	99.4	103.5	89.1
Operating Cashflow	86.0	133.0	152.6	139.9
DPS	0.0	0.0	0.0	0.0
Profitability (%)				
Operating Margin	61.2	74.5	70.2	63.1
ROAE	28.7	29.2	26.1	18.4
Momentum (%)				
Sales	86.4	38.7	8.9	-7.2
EBITDA	70.7	60.4	4.8	-9.9
Adjusted EPS	68.1	67.8	4.1	-13.9
Financing				
Debt/Equity (%)	n/m	n/m	n/m	n/m
Interest Cover (x)	n/m	n/m	n/m	n/m
Valuation (x)				
P/E	10.6	6.3	6.1	7.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
EV/EBITDA	5.7	3.3	2.8	2.7
P/NAV	3.0	2.1	1.6	1.3
Price Performance				
52 Week		Tickers		
High	1120	Reuters	DGO.L	
Low	410	Bloomberg	DGO LN	
Absolute Price Change (%)		FTSE Oil & Gas Rel.PrcChg		
QTD	-33.5	QTD	7.6	
YTD	-11.9	YTD	7.6	

Gross Production (Average per period)



Dragon Oil

Period Ending	Interim Results (\$m)				Forecast		Change on H1 FY07	Forecast Variance
	Jun-06 H1	Dec-06 H2	Jun-07 H1	Dec-07 H2	Jun-08 H1	Jun-08 H1		
Group Sales	143.9	176.2	213.2	383.4	410.9	373.5	75.2%	-9.1%
Operating Costs	-17.9	-22.8	-27.1	-21.6	-29.5	-36.1	33.4%	22.5%
D&A	-27.1	-34.2	-42.4	-59.5	-60.9	-61.7	45.6%	1.3%
Adjustment					0.0	24.3		
Gross Profit	98.9	119.1	143.7	302.3	320.5	299.9	108.7%	-6.4%
Admin. Expenses	-4.5	-1.9	-7.8	-10.5	-14.3	-8.3	6.9%	-41.8%
Other Income	1.1	-0.5	0.1	-14.7	0.0	0.0	-62.1%	n/m
Operating Profit	95.5	116.7	136.0	277.1	306.2	291.6	114.4%	-4.8%
Exceptional Gain / (Loss)	0.0	0.0	0.0	0.0	0.0	0.0	n/m	n/m
EBIT	95.5	116.7	136.0	277.1	306.2	291.6	114.4%	-4.8%
Interest Income / (Expense)	5.2	6.8	7.9	11.2	12.0	11.4	43.8%	-5.0%
Hedge Loss	0.0	0.0	0.0	0.0	-91.0	-91.4	n/m	0.5%
PBT	100.7	123.5	143.9	288.4	227.2	211.6	47.0%	-6.9%
Tax	-19.7	-24.0	-29.0	-51.3	-45.4	-44.7	54.3%	-1.6%
Minorities	0.0	0.0	0.0	0.0	0.0	0.0	n/m	n/m
Preference Dividends	0.0	0.0	0.0	0.0	0.0	0.0	n/m	n/m
Attributable Profit	81.0	99.5	114.9	237.0	181.8	166.9	45.2%	-8.2%
EBITDAe	122.6	151.0	178.4	336.7	367.1	353.3	98.1%	-3.7%
Net Debt (Cash)	-265.8	-296.2	-296.2	-548.6	-653.9	-658.8	122.4%	0.8%
Shareholders' Funds	642.0	741.9	754.3	1060.4	1314.2	1239.5	64.3%	-5.7%
Enterprise Value	2953.2	2922.8	2922.8	2670.4		2560.2	-12.4%	n/m
Weighted Av Shares (basic)	510.1	510.3	510.5	511.1	510.8	512.9	0.5%	0.4%
Weighted Av Shares (fully diluted)	512.5	511.7	511.9	514.0	513.6	515.9	0.8%	0.5%
Per share Analysis (p)								
FRS3 EPS	15.9	19.5	22.5	46.4	35.6	32.5	44.5%	-8.6%
FD EPS	15.8	19.4	22.5	46.1	35.4	32.3	44.0%	-8.6%
Adjusted EPS	15.8	19.4	22.5	46.1	49.4	46.4	106.6%	-6.1%
DPS	0.0	0.0	0.0	0.0	0.0	0.0		
Dividend Cover (x)	n/m	n/m	n/m	n/m	n/m	n/m		
Operating Cashflow	20.5	24.0	25.6	59.9	57.3	61.3		
Free Cashflow	10.7	5.9	-3.3	4.8	21.5	19.1		
NAV	125.3	145.0	147.4	206.3	255.9	240.2		
Profitability								
EBITDAe Margin	85.2%	85.7%	83.7%	87.8%	89.3%	94.6%		
EBIT Margin	66.4%	66.3%	63.8%	72.3%	74.5%	78.1%		
Effective Tax Rate	19.6%	19.4%	20.1%	17.8%	20.0%	21.1%		
Momentum								
Sales	179.8%	22.5%	21.0%	79.9%	7.2%	-2.6%		
EBITDAe	327.5%	23.2%	18.1%	88.7%	9.0%	4.9%		
Adjusted EPS	-389.3%	23.1%	15.4%	105.4%	7.1%	0.6%		
DPS	n/m	n/m	n/m	n/m	n/m	n/m		
Financing								
Debt/Equity (%)	n/m	n/m	n/m	n/m	n/m	n/m		
Interest Cover (x)	-23.5	-22.2	-22.5	-30.0	-30.6	-31.0		

Dragon Oil - Forecast Changes

Year Ending (Dec)	2008			2009			
	\$m	New	Old	% Change	New	Old	% Change
Group Sales	827.5	851.1		-3%	901.5	871.5	3%
Operating Costs	-77.6	-63.6		22%	-89.1	-73.9	21%
DD&A	-132.7	-127.3		4%	-152.4	-145.1	5%
Adjustment	24.3	0.0			0.0	0.0	
Administration	-25.3	-28.6		-12%	-27.6	-29.3	-6%
Other Income	0.0	0.0			0.0	0.0	
Operating Profit	616.2	631.6		-2%	632.5	623.2	1%
Exceptional Gain	0.0	0.0			0.0	0.0	
EBITDA	748.9	758.8		-1%	784.9	768.3	2%
Net Interest	26.3	26.5		-1%	36.1	38.4	-6%
Hedge Loss	-91.4	-91.0			0.0	0.0	
PBT	551.1	567.1		-3%	668.6	661.6	1%
Tax	-110.2	-113.4		-3%	-133.7	-132.3	1%
Attributable Profit	440.9	453.6		-3%	534.9	529.3	1%
Per share Analysis (p)							
FRS3 EPS	86.0	88.8		-3%	104.3	103.6	1%
FD EPS	85.4	88.4		-3%	103.5	103.1	0%
Adjusted EPS	99.4	102.4		-3%	103.5	103.1	0%
DPS	0.0	0.0		0%	0.0	0.0	0%

Source: Goodbody Stockbrokers

Dragon Oil NAV Calculation

	Reserves mmboe	NAV \$m	NAV/Share \$c	NAV/Share £p	NAV/Share €c
Commercial Reserves					
Cheleken	324.8	3643.6	710.4	370.7	473.6
Commercial NAV	324.8	3643.6	710.4	370.7	473.6
Low Risk Development					
Low Risk Development NAV	0.0	0.0	0.0	0.0	0.0
Less Net Debt		658.8	128.5	67.0	85.6
Total Core NAV (pence)			838.9	437.7	559.3
High Risk Development	Net Reserves				
Other (Gas Assets)	291.7	855.9	166.9	87.1	133.5
High Risk Development					
Yemen (Blocks 35, 49 & R2)	1.7	28.4	5.5	2.9	4.4
High Risk Exploration NAV	293.3	884.4	172.4	90.0	137.9
Total NAV			1011.3	527.7	697.2

Source: Goodbody Stockbrokers

Dragon Oil

Balance Sheet (\$m)

As at	Dec-05	Dec-06	Dec-07	Dec-08f	Dec-09f	Dec-10f
Tangible Assets	398.7	512.8	639.2	866.7	1,114.3	1,285.6
Intangible Assets	0.0	0.0	0.8	0.8	0.8	0.8
<i>Goodwill</i>	0	0	0	0	0	0
Financial Assets	0	0	0	0	0	0
Fixed Assets	398.7	512.8	640.0	867.5	1,115.1	1,286.5
Debtors	22.8	37.7	94.9	173.7	172.8	164.0
Stock	9.7	47.0	34.7	36.2	39.4	36.6
Creditors	-40.8	-100.6	-201.4	-267.7	-267.5	-266.3
Non-Cash Working Capital	-8.2	-15.9	-71.9	-57.7	-55.3	-65.7
Other Liabilities	47.6	51.2	56.4	64.1	64.1	64.1
Net Debt	-218.2	-296.2	-548.6	-764.9	-1,049.7	-1,349.7
Preference Shares	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' Funds	561.0	741.9	1,060.4	1,510.5	2,045.4	2,506.3
Total	390.5	497.0	568.2	809.8	1,059.9	1,220.8

Cashflow Statement (\$m)

Year End	Dec-05	Dec-06	Dec-07	Dec-08f	Dec-09f	Dec-09f
Operating Profit	74.7	224.2	432.3	550.4	668.6	576.1
DD&A	43.7	61.5	102.0	132.8	152.4	178.7
Chg in Stock, Debtors, Creditors	-11.4	-45.9	-99.2	-32.1	-2.5	10.4
Other	3.1	-11.8	4.3	30.8	-36.1	-47.8
Operating Cashflow	110.0	228.0	439.4	681.9	782.4	717.4
Net Interest Payable	-0.4	10.7	-0.2	25.7	36.1	47.8
Dividends Received	0.0	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0	0.0
Taxation	0.0	-5.3	-39.7	-153.0	-133.7	-115.2
Net Capex	-96.2	-155.8	-236.5	-350.0	-400.0	-350.0
Other	0.1	7.7	15.4	0.0	0.0	0.0
Free Cashflow	13.6	85.3	178.4	204.6	284.8	300.0
Acquisitions/Development Capex	0.0	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Issue / Buyback of Shares	157.8	0.0	0.9	11.7	0.0	0.0
Currency Translation	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
(Inc)/Dec in Net Debt	171.4	85.4	179.2	216.3	284.8	300.0

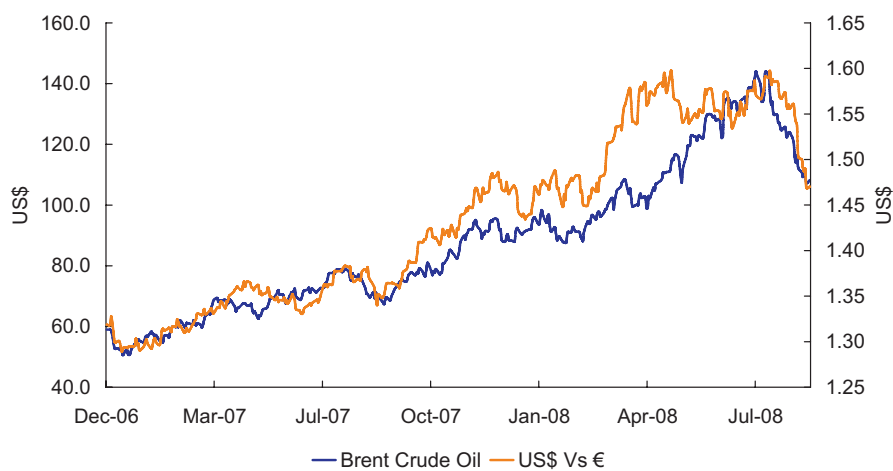
	\$	£	Euro			
Dragon Oil	3,218.98	1,679.61	2,099.52	Mkt Cap		
Financial Overview (\$m)						
Year Ending	Dec-05	Dec-06	Dec-07	Dec08f	Dec09f	Dec10f
Group Sales	164.2	320.1	596.6	827.5	901.5	837.0
Operating Costs	-34.0	-40.7	-48.7	-77.6	-89.1	-104.5
DD&A	-43.6	-61.3	-101.9	-132.7	-152.4	-178.7
Other (Over/Underlift)	0.0	0.0	-48.0	24.3	0.0	0.0
Cost of Sales	-77.6	-102.0	-198.7	-185.9	-241.5	-283.1
Admin. Expenses	-9.7	-6.4	-18.2	-25.3	-27.6	-25.6
Other	1.4	0.5	-14.6	0.0	0.0	0.0
Operating Profit (ex Goodwill)	78.3	212.2	365.1	616.2	632.5	528.3
Goodwill Write-off	0.0	0.0	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0	0.0	0.0
Associates / Joint Ventures	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional Gain / (Loss)	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	78.3	212.2	365.1	616.2	632.5	528.3
Interest Income / (Expense)	-3.6	12.0	19.2	26.3	36.1	47.8
Hedging Loss	0.0	0.0	0.0	-91.4	0.0	0.0
PBT	74.7	224.2	384.3	551.1	668.6	576.1
Tax	-52.9	-43.7	-80.3	-110.2	-133.7	-115.2
Attributable Profit	21.8	180.5	303.9	440.9	534.9	460.9
EBITDA	121.9	273.6	467.0	748.9	784.9	707.0
Net Debt (Cash)	-218.2	-296.2	-548.6	-764.9	-1049.7	-1349.7
Shareholders' Funds	561.0	741.9	1060.4	1510.5	2045.4	2506.3
Enterprise Value	3000.8	2922.8	2670.4	2454.1	2169.3	1869.3
<i>Weighted Av Shares (basic)</i>	471.2	510.2	510.8	512.9	512.9	512.9
<i>Weighted Av Shares (fully diluted)</i>	473.9	512.1	512.9	516.4	516.9	517.4
<i>Year end Shares</i>	473.9	512.1	512.9	516.4	516.9	517.4
Per share Analysis (c)						
FRS3 EPS	4.6	35.4	59.5	86.0	104.3	89.9
FD EPS	4.6	35.2	59.2	85.4	103.5	89.1
Adjusted EPS	4.6	35.2	59.2	99.4	103.5	89.1
DPS	0.0	0.0	0.0	0.0	0.0	0.0
Dividend Cover (x)	0.0	0.0	0.0	0.0	0.0	0.0
Operating Cashflow	23.2	44.5	85.7	132.1	151.4	138.7
Free Cashflow	2.9	16.7	1.6	39.6	55.1	58.0
NAV	118.4	144.9	206.7	292.5	395.7	484.4
Profitability						
EBITDA Margin	74.2%	85.5%	78.3%	90.5%	87.1%	84.5%
EBIT Margin	47.7%	66.3%	61.2%	74.5%	70.2%	63.1%
Effective Tax Rate	70.8%	19.5%	20.9%	20.0%	20.0%	20.0%
Momentum						
Sales	69.2%	94.9%	86.4%	38.7%	8.9%	-7.2%
EBITDA	65.5%	124.5%	70.7%	60.4%	4.8%	-9.9%
Adjusted EPS	-62.2%	665.7%	68.1%	67.8%	4.1%	-13.9%
Financing						
Debt/Equity (%)	n/m	n/m	n/m	n/m	n/m	n/m
Interest Cover (x)	34.3	n/m	n/m	n/m	n/m	n/m
Valuation (x) £p 328						
P/E	136.4	17.8	10.6	6.3	6.1	7.0
P/OpCF	27.0	14.1	7.3	4.8	4.1	4.5
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
EV/Sales	18.3	9.1	4.5	3.0	2.4	2.2
EV/EBITDA	24.6	10.7	5.7	3.3	2.8	2.6
EV/EBIT	38.3	13.8	7.3	4.0	3.4	3.5
P/Book	5.3	4.3	3.0	2.1	1.6	1.3

Dragon - Underlying Price Assumptions

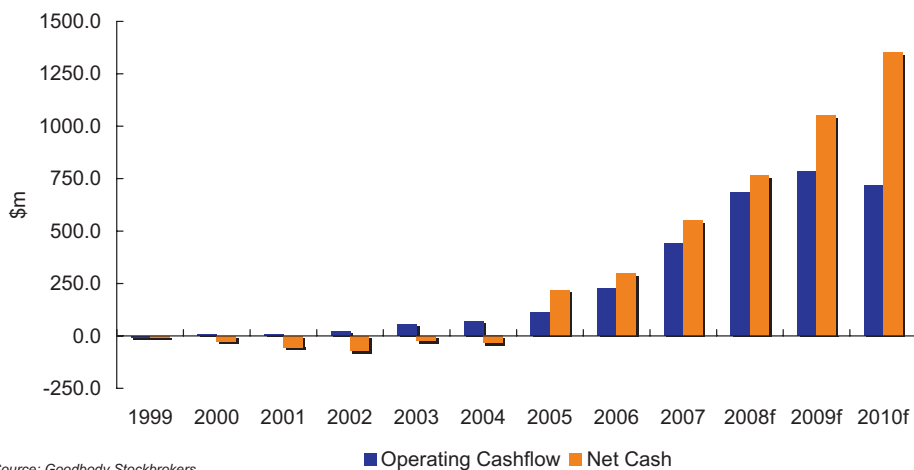
	2008	2009	2010	2011
New Oil Price - (\$/barrel)	109.84	100.00	80.00	75.00
Old Oil Price - (\$/barrel)	112.34	100.00	80.00	75.00
New \$/£ Exchange Rate	1.99	1.92	1.95	1.95
Old \$/£ Exchange Rate	1.99	1.92	1.95	1.95
New Turk Gas Price (\$/kcf)	2.50	2.58	2.65	2.73
Old Turk Gas Price (\$/kcf)	2.50	2.58	2.65	2.73

Source: Goodbody Stockbrokers

Brent Crude Oil Vs €/US\$



Dragon - Operating Cashflow & Net Cash



Source: Goodbody Stockbrokers

ISSUER & ANALYST DISCLOSURES

Rating & Price Target History

Date	From	To	Price Target
18-Sep-07	Buy	Add	£2.50
02-Oct-07	Add	Buy	£2.75
06-Mar-08	Buy	Add	£5.35
25-Jul-08	Add	Buy	£5.65

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