

Europe, Middle East & Africa: Energy: Oil & Gas - E&P

“Jam tomorrow” doesn’t cut the mustard - initiate on three small-cap E&P companies

Initiating coverage on three stocks

We initiate coverage on three oil exploration and production companies. Oil E&P equities have endured a period of weak performance as oil has retraced from recent highs of \$145 to currently around \$100/barrel. At the same time oil equities in our E&P coverage have underperformed the oil price and we now believe they are discounting approximately \$75/barrel for oil. We believe Dragon Oil is the best positioned of our three initiations as it has strong cash flow from a robust production profile, a net cash balance of \$540 mn, as well as a large oil reserve base.

Additionally, we re-iterate our Buy ratings on Regal Petroleum and JKX Oil and Gas.

Best buy idea

We initiate on Dragon Oil as Buy with a 6-month price target of 366p. We re-iterate Buy ratings on JKX Oil and Gas (6-month price target 549p) and Regal Petroleum (12-month price target 243p)

Neutral: Cadogan Petroleum, Heritage Oil

We initiate coverage of Cadogan Petroleum and Heritage Oil with Neutral ratings. Our 6-month price target for Cadogan is 132p and 317p for Heritage.

RATING AND PRICE TARGET SUMMARY

Name	Rating	Price target
Cadogan Petroleum PLC	Neutral	132p
Dragon Oil PLC	Buy	366p
Heritage Oil	Neutral	317p
JKX Oil and Gas	Buy	549p
Regal Petroleum*	Buy	243p

**6-month price target for all names above except for Regal Petroleum which has a 12-month price target*
Source: Goldman Sachs Research.

Coverage view: Neutral

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Prices in this report are as of the close September 22, 2008.

Overview: How to buy oil at \$75/barrel

We initiate coverage on three small-cap E&P companies: Dragon Oil (Buy), Cadogan Petroleum (Neutral) and Heritage Oil (Neutral). We explore the recent performance of the three stocks against our existing coverage group of JKX Oil and Gas (Buy) and Regal Petroleum (Buy).

We initiate coverage on Dragon Oil (Buy), Heritage Oil (Neutral) and Cadogan Petroleum (Neutral)

We initiate coverage on Dragon Oil with a Buy rating and 6-month price target of 366p. We like the strong cash generation from the main producing asset in Turkmenistan and believe that the stock is currently pricing oil at \$77/barrel from 2009 into the long-term. Alternatively, on current oil price assumptions, the stock is pricing a “free option” on the cash and development upside.

We also initiate on Heritage Oil (Neutral, 6-month price target of 317p) and Cadogan Petroleum (Neutral, 6-month price target 132p). Although we see 40% and 43% upside potential to the respective price targets, not enough upside relative to our peer group to justify a Buy recommendation in our opinion.

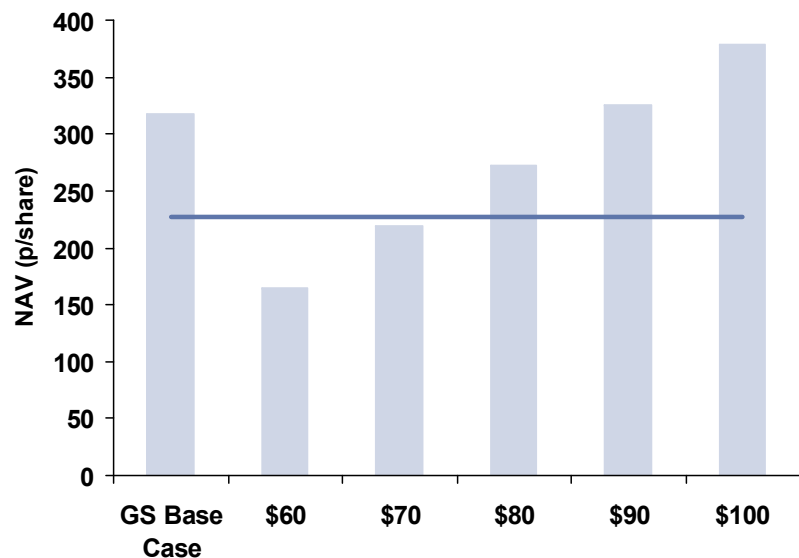
We reduce our price targets for both JKX (Buy, 6-month price target reduced from 578p to 549p) and Regal Petroleum (Buy, 12-month price target reduced from 344p to 243p) as a result of the new GS oil price forecasts published on September 17, 2008, *Macro headwinds have increased, but energy equities appear oversold; buy the correction*, and an increase in the Ukrainian WACC to 11%. With Regal Petroleum, we also value the company on the assumption that debt finance will be increasingly difficult to raise and therefore assume a “go-slow” development funded entirely from the group’s current cash balances. This results in a slower ramp up in production in the MEX-GOL and SV fields and consequently reduces our SOTP-based valuation.

Equities now discounting sustained fall in oil price: We estimate \$75 per barrel on average

We calculated how the valuation of our coverage group changes in different oil price scenarios and conclude that both our “pure-play” oil stocks, Dragon Oil and Heritage Oil, are discounting oil prices below \$80 from 2009 continuing into the long term. We estimate that Dragon Oil is discounting an oil price of \$77/barrel and Heritage Oil a price of c.\$72/barrel.

Exhibit 1: Heritage Oil discounting c.\$72/barrel from 2009

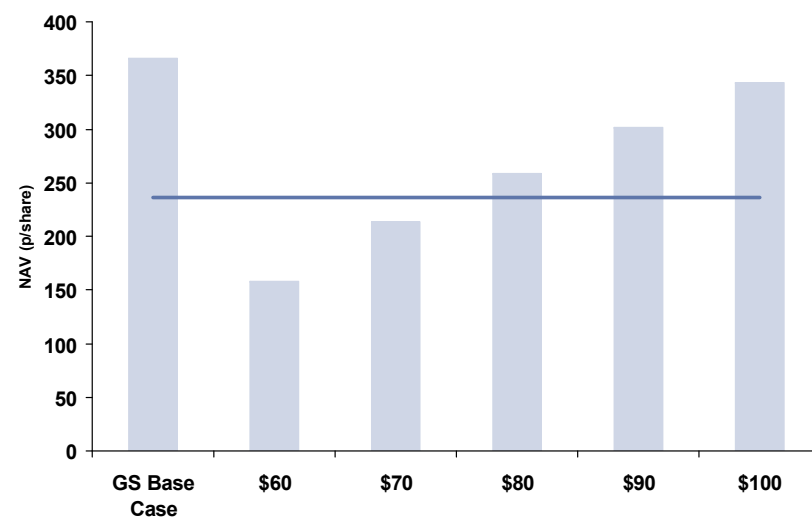
Valuations assuming flat oil price from 2009



Source: Goldman Sachs Research estimates.

Exhibit 2: Dragon Oil discounting c.\$77/barrel from 2009

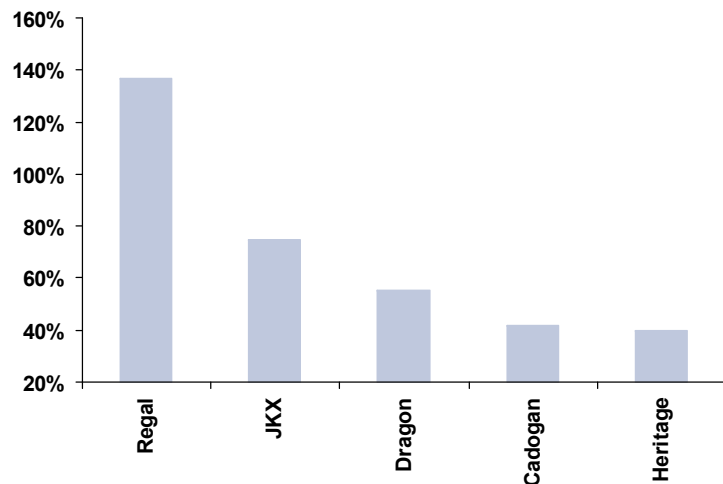
Valuations assuming flat oil price from 2009



Source: Goldman Sachs Research estimates.

Exhibit 3: Upside potential to price targets across E&P coverage

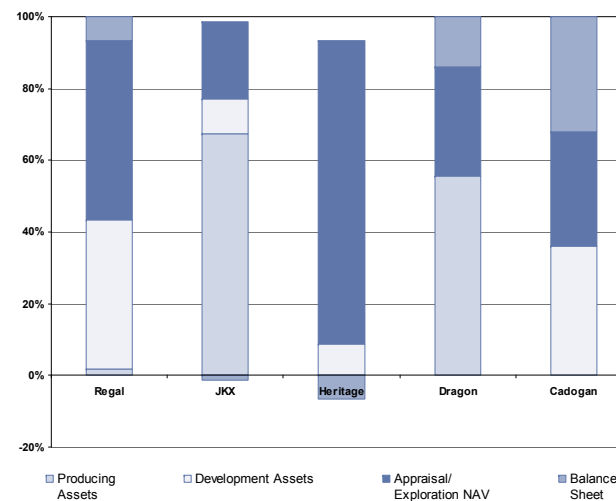
Survey of E&P stocks covered in Mid-cap team



Source: Datastream, Goldman Sachs Research estimates.

Exhibit 4: Composition of NAV across Mid-cap peer group

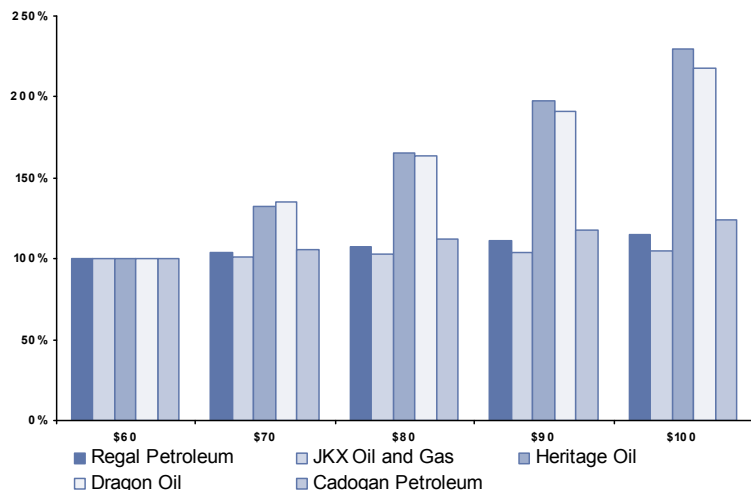
Dragon and JKX have most value in producing assets



Source: Goldman Sachs Research estimates.

Exhibit 5: Valuation accretion across different oil price scenarios

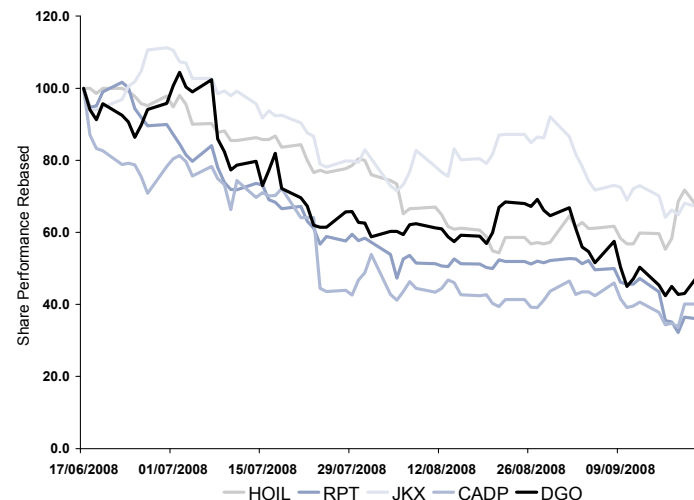
Rebased



Source: Goldman Sachs Research estimates.

Exhibit 6: Mid-cap coverage since CADP IPO

3-mth performance highlights steep decline in equity performance since mid-2008

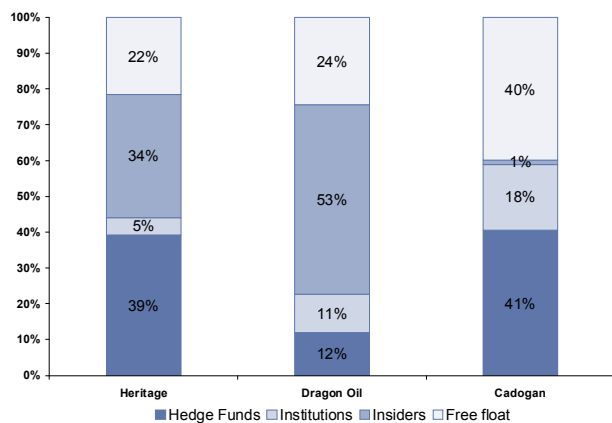


Source: Datastream

Significant hedge fund presence in coverage space

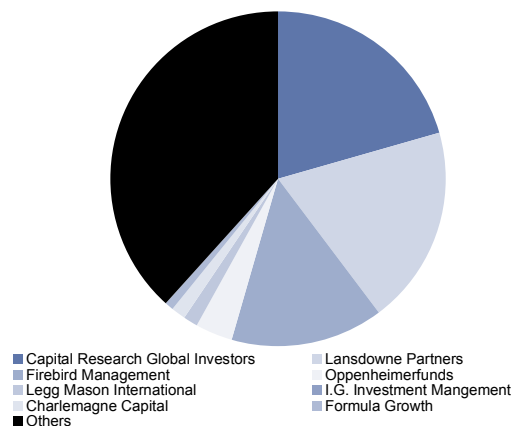
We note there is a high level of hedge fund holding across the companies we are initiating coverage over. What is also noteworthy is the low level of institutional holdings across these companies. Dragon appears to have the most stable shareholder base with 53% of the shares held by insiders and only a 24% free-float.

Exhibit 6: Low institutional holdings in companies
at September 15, 2008



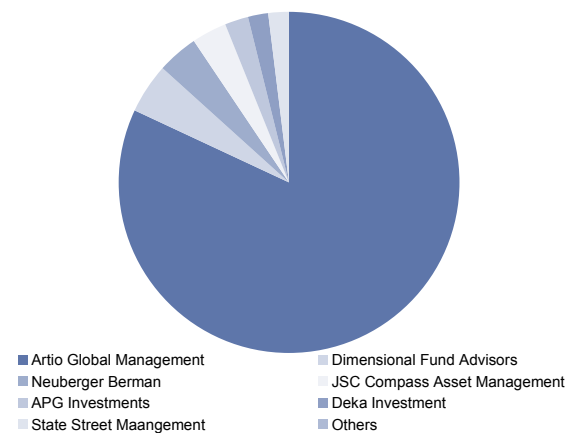
Source: Goldman Sachs Research, Thompson Reuters, Bloomberg.

Exhibit 8: Hedge fund holding represents 39% of shareholder base
Composition of hedge fund holdings of Heritage Oil at September 15, 2008



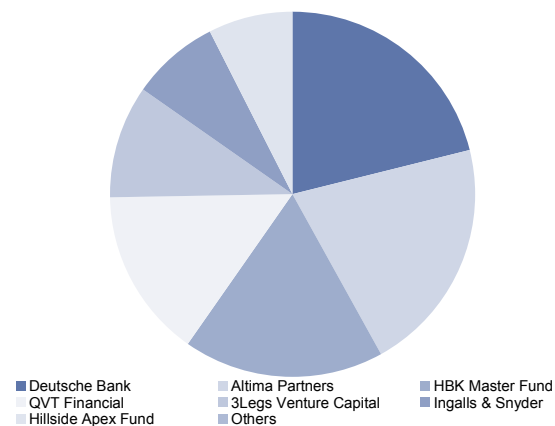
Source: Goldman Sachs Research, Thompson Reuters, Bloomberg.

Exhibit 7: Hedge fund holding represents 12% of shareholder base
Composition of hedge fund holdings of Dragon Oil at September 15, 2008



Source: Goldman Sachs Research, Thompson Reuters, Bloomberg.

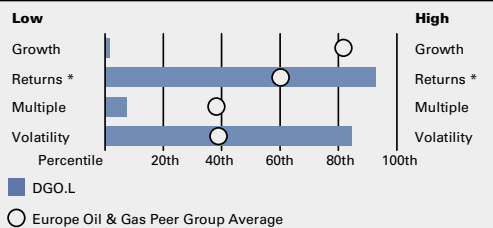
Exhibit 9: Hedge fund holding represents 41% of shareholder base
Composition of hedge fund holdings of Cadogan Petroleum at September 15, 2008



Source: Goldman Sachs Research, Thompson Reuters, Bloomberg.

Dragon Oil (DGO.L): Unfashionable, but transformation underway; initiate as Buy

Investment Profile: Dragon Oil PLC

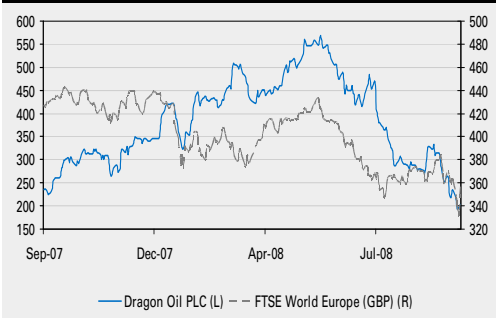


* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (p)	236.50
6 month price target (p)	366
Upside/downside (%)	55
Market cap (£ mn)	1,209.0
Enterprise value (\$ mn)	1,148.4

	12/07	12/08E	12/09E	12/10E
EBIT (£ mn)	365.1	421.2	595.6	463.6
EPS (p)	0.60	0.70	0.98	0.78
P/E (X)	373.3	315.5	241.9	301.8
EV/DACF (X)	3.8	5.7	2.6	5.4
Dividend yield (%)	NM	NM	NM	NM
FCF yield (%)	11.7	3.2	5.6	(4.4)
CROCI (%)	55.5	25.2	36.6	13.6
CROCI/WACC (X)	--	--	--	--
EV/GCI (X)	1.9	1.2	0.8	0.6

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(43.5)	(45.6)	1.5
Rel. to FTSE World Europe	(39.6)	(42.5)	21.7

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/22/2008 close.

Source of opportunity

Dragon Oil is trading at a 56% discount to NAV. There is strong upside potential on an absolute and relative basis at current prices. The company is production focused and we believe they will be able to double oil production to around 100k bopd within the next three years. At current levels the stock is trading at an 8% discount to its core NAV of producing and financial assets, and we estimate it is discounting an effective oil price of \$77/barrel from 2009 onwards. We initiate with a Buy recommendation.

Catalyst

As the company has only immaterial exploration and appraisal opportunities, we believe the stock will be catalysed by incremental development milestones being achieved over the course of the next 18 months. These include lifting group production to c.40kbopd by the end of 2008, submitting an FDP addendum to the Turkmenistan Government in 4Q08 and continuing announcements relating to contracts for the re-development of surface facilities at the Cheleken area. The stabilization of the oil price in the current market could also act as a catalyst for the stock which is pricing a sustained decline below \$80/barrel.

Valuation

We set our 366p, 6-month price target based on a SOTP methodology including the discounted cash flow of the company's producing and near-term development assets and a risked assessment of its appraisal and exploration projects.

Key risks

Key risks to our view and price target include continued declines and volatility in the oil price. Operational risks include worse than anticipated performance of producing wells at the Cheleken Area, a delay in construction of extra capacity at the field and difficulties and delays in bringing additional drilling rigs into the region. The company has large exposure to any political volatility in Turkmenistan and fiscal renegotiation should also be considered a risk to the investment case.

Source: Company data, Goldman Sachs Research estimates, FactSet.

Company overview

Dragon Oil is a production and development orientated E&P company, with operational focus on their 100% working interest in the Cheleken PSC in Turkmenistan. The company is a direct beneficiary of Turkmenistan's growing profile within the oil industry. It is currently undertaking a major refurbishment and expansion of its onshore processing facilities and drilling capabilities in the Caspian. As a result by 2010, we believe that oil production capacity could more than double to 100kbopd and gas processing facilities could provide a commercial route for the associated gas at Cheleken (currently c.20mmscf/d is flared). The company is 55% owned by ENOC (Emirates National Oil Company), however despite holding an asset of clear strategic value (the acquisition of Dragon could provide "oil majors" with an excellent foundation asset in Turkmenistan), we do not believe M&A is likely in the stock. It is more likely that Dragon will seek to acquire an asset in order to diversify its portfolio away from the Caspian region, in our view.

At the current share price, we estimate that Dragon implies an oil price of \$77/barrel from 2009 onwards; significantly below our forecasts. The stock is trading below our calculation of Core NAV of 255p (c.8% discount) suggesting that upside from developments at Cheleken are a "free option" at current price levels. We believe that the current levels provide an excellent entry level on an absolute and sector-relative basis. We initiate coverage with a Buy recommendation and 366p 6-month price target.

Exhibit 10: Dragon Oil is a pure play on Turkmenistan and has a strong net cash position

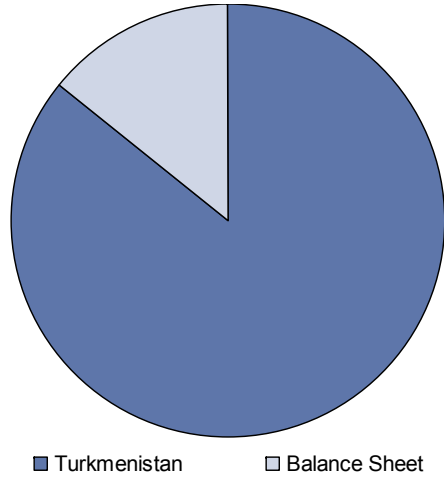
Dragon Oil - Net asset value

Dragon Oil							
Producing assets	WACC	Risk	Reserves (mmboe)	NPV \$/bbl	NPV \$m	NPV £m	NPV p/s
Cheleken PSC- 1P Reserve development	12%	100%	319	5.8	1859.1	1041.6	204
					1859.1	1041.6	204
Corporate and non-debt financial liabilities					-70.2	-39.2	-8
Net Cash					543.2	301.8	59
Production + Financial Assets			319		2332.2	1304.2	255
Core NAV			319		2332.2	1304.2	255
Contingent Assets							
Cheleken PSC- 2P Reserve development and Gas Project	12%	100%	429	2.3	1005.4	567.2	111
			429		1005.4	567.2	111
Total NAV			748		3337.6	1871.4	366

Source: Goldman Sachs Research estimates.

Exhibit 11: Pure-play on Turkmenistan

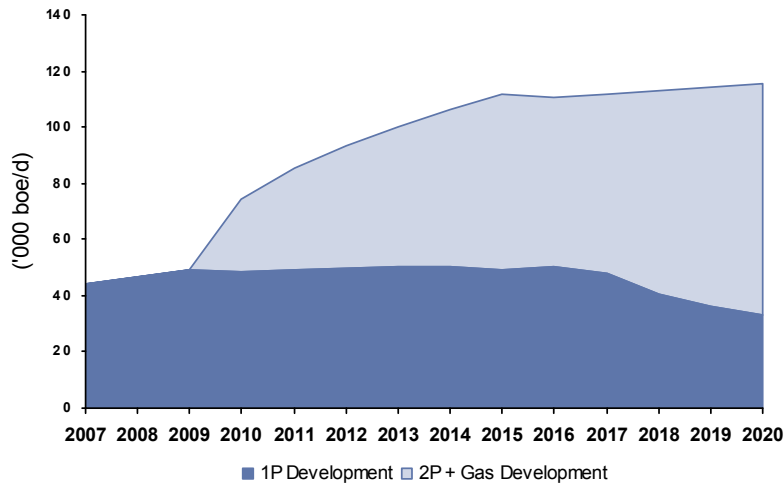
Cheleken PSC accounts for full value of oil assets alongside strong balance sheet



Source: Goldman Sachs Research estimates.

Exhibit 13: Potential for significant uplift in production profile

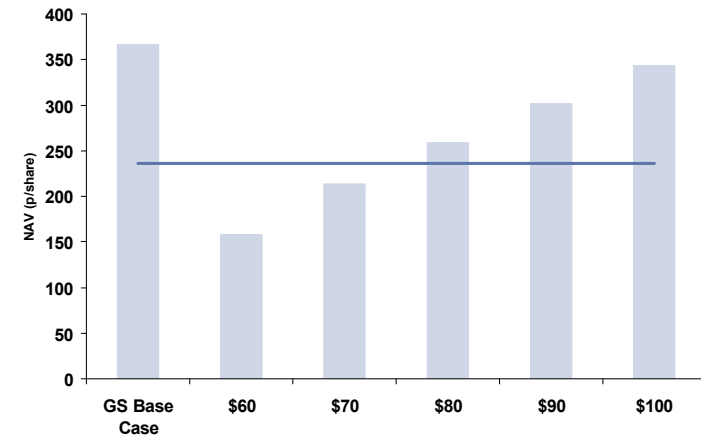
Successful development would more than double plateau production level.



Source: Goldman Sachs Research estimates.

Exhibit 12: Current share price implies oil price of c.\$77

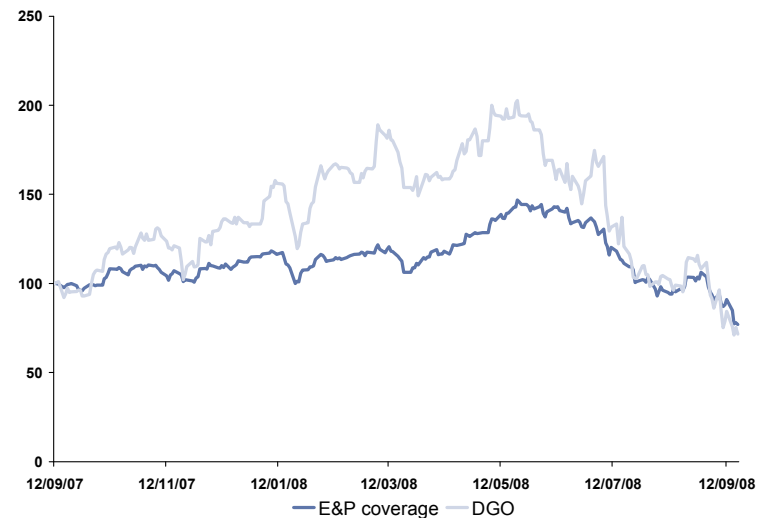
We see fair value at 366p per share



Source: Goldman Sachs Research estimates.

Exhibit 14: Dragon Oil price performance vs. E&P sector

12-month performance, rebased



Source: Goldman Sachs Research estimates.

Operational highlights

Although the company has a few small assets in Yemen (to which we ascribe no value in our NAV or price target), Dragon is basically a pure-play on Turkmenistan and the development of the Cheleken Contract Area (offshore Caspian). In the terms of this PSC, the company holds an asset of considerable development potential: a reserve report at year-end 2007 ascribed 640 million barrels of oil as 2P reserves on the field. Although current production is approximately 40,000bpd oil, we believe that with a sustained drilling programme, refurbishment of surface facilities and expansion of export capacity, this could be increased to 100,000bpd oil by 2013. This peak in the production profile could be enhanced further if more rigs can be sourced onto the fields. We currently assume a three rig campaign drilling a conservative eight wells per year (the company believes that between 8- 12 wells are achievable each year from three rigs).

The company has entered a period of intensive capital expenditure at the Cheleken area. We forecast that the company will spend \$100 mn in 2008 on facilities capex and a further \$265 mn in 2009 to refurbish existing infrastructure. This is in addition to drilling capex of approximately \$200 mn per year for development drilling. In order to expand processing and export capacity to approximately 100kbpd for oil and 20boepd for gas, we estimate a further \$350 mn will be needed between 2008 and 2010.

Exhibit 15: Free cash flow generation varies significantly under different oil price scenarios

Note net cash balance at FY2007 means development fully funded even at \$60/barrel to 2011E.

Free Cash Flow	2008E	2009E	2010E	2011E
GS Base Case	43	93	-132	56
GS +10%	43	97	-132	55
GS -10%	43	90	-132	58
\$60	43	-202	-112	144
\$70	43	-78	11	59
\$80	43	46	-102	58
\$90	43	86	-140	60
\$100	43	90	-141	59

Source: Goldman Sachs Research estimates.

Exhibit 15 shows the free cash flow of Dragon Oil under differing oil price scenarios. In the \$60 through \$100 scenarios, we assume that the oil price will be at these respective prices for 2009E, 2010E and 2011E. We assume the base case GS forecast of \$113 for 2008E in all scenarios. We forecast that under all our oil price scenarios, Dragon will be able to cover its capital expenditure programme from current cash deposits and free cash flow.

Production can be further enhanced by commercialization of the significant associated gas resources on the Cheleken PSC area. Turkmenistan is reported to have the fourth largest gas reserves in the world and therefore has the potential to become a significant producer of gas in the future. The country is also well placed geographically, with commercial options including further enhancing export capacity north to Russia, south-west to Iran, south-east to China or across the Caspian to feed the proposed Nabucco pipeline direct to Europe. The price of gas in Turkmenistan has increased significantly since 2005. Prices have risen from \$50/mcm in 2005 to \$180/mcm currently.

Dragon flares 20mmscf/d of associated gas from the Cheleken field and is currently in discussions with the Government of Turkmenistan over commercial options for this gas. We anticipate an announcement by the end of the year concerning the gas export arrangements, but we understand from management that gas will be sold to the central government under the terms of the existing PSC. We assume that Dragon Oil will be able to sell their gas at an export equivalent price to encourage their proposed \$200 mn investment in the gas processing facilities and export pipeline.

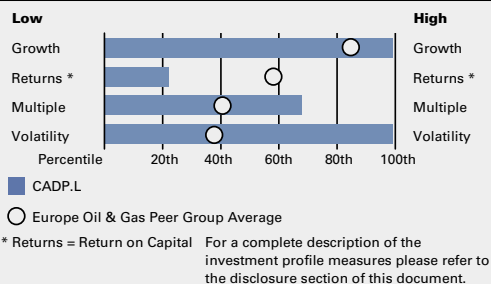
Exhibit 16: Catalysts related to development could be in place by the end of 2008

Q4 2008	Drilling Report- October
	Interim Management Statement- 22nd October
	Drilling Report- November
	Announcement on Rig Contract (provisional)
	Announcement on award of contract for Phase 2 of new processing facility (provisional)
Q1 2009	Trading Statement January 2009
	FY 2008 Results March 2009
Q2 2009	Announcement on award of contract for gas processing facility (provisional)
2009	8-12 well development drilling campaign across 2009

Source: Company Data, Goldman Sachs Research estimates.

Cadogan Petroleum (CADP.L): License issues overshadow company; initiate as Neutral

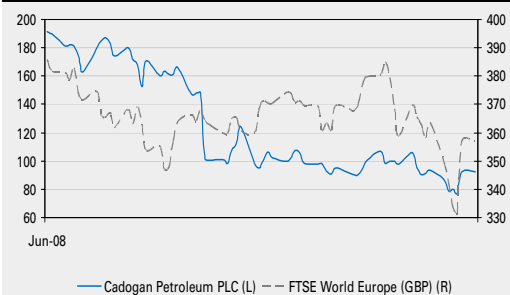
Investment Profile: Cadogan Petroleum PLC



Key data	Current
Price (p)	92.25
6 month price target (p)	132
Upside/(downside) (%)	43
Market cap (£ mn)	213.2
Enterprise value (£ mn)	100.1

	12/07	12/08E	12/09E	12/10E
EBIT (£ mn)	(15.2)	(15.1)	22.8	90.1
EPS (p)	(0.14)	(0.03)	0.08	0.27
P/E (X)	--	NM	NM	336.6
EV/DACF (X)	--	NM	7.6	3.2
Dividend yield (%)	--	NM	NM	NM
FCF yield (%)	--	(77.8)	(52.4)	(32.4)
CROCI (%)	--	(9.7)	9.7	20.1
CROCI/WACC (X)	--	--	--	--
EV/GCI (X)	--	0.5	0.6	0.5

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(51.4)	--	--
Rel. to FTSE World Europe	(48.1)	--	--

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/22/2008 close.

Investment view

We believe that concerns over license validity significantly cloud the investment case for Cadogan at the current time. Although there are numerous operational catalysts and the company has significant potential for reserve upgrades from appraisal and exploration drilling in the next 6-9 months, we do not believe this will crystallise in the share price unless the court rulings that have effectively invalidated two of the company's licenses are overturned. We initiate with a Neutral rating and a 132p 6-month price target.

Core drivers of growth

Growth in the company is likely to be driven by an active drilling campaign across the next twelve months as it seeks to increase both its production base and reserve base in Ukraine. The company is well funded and we believe they can cover their development costs from cash balances and operational cash flow from their main field into 2010.

Risks to the investment case

Risks to our view and price target include the upholding of the license challenges at appeal and further challenges to licenses within the group's portfolio. Fiscal renegotiation remains a risk on the downside, alongside lower-than-expected gas prices in Ukraine and a fall in oil prices. Unanticipated cost escalation and operational delays also represent risks on the downside. Successful appraisal/exploration drilling and increases in the Ukrainian gas price above our current forecasts are upside risks.

Valuation

We set our 132p 6-month price target based on a SOTP methodology including the discounted cash flow of the company's producing and near-term development assets and a risked assessment of its appraisal and exploration projects.

Company overview

Cadogan Petroleum has endured a difficult infancy as a listed company. Since its IPO on June 17, 2008 the shares have fallen by 60% on the back of license challenges in Ukraine that if ratified would forfeit the company's rights to its core asset the Pirkovskoe field. However, the retrenchment of the share price following the announcement in relation to the challenges now largely discounts the risk of these events. Net cash of \$271 mn on the balance sheet represents 60p/share worth of value in our price target.

Operational Overview

Cadogan has the largest portfolio of Ukrainian assets of our coverage group, with assets in both the Carpathian basin, west Ukraine, as well as the Dniepr-Donets basin, east Ukraine. The company's principle asset is the Pirkovskoe license, which contains c.80 mn boe of gas and condensate (predominantly gas). Separate from this are the Zagoryanska and Bitlyanska licenses which contain a combined 320 mn boe of contingent resources. The company's principle strategy across the next year is to convert as much of the contingent resources into 2P reserves as possible and increase the company's production profile by development drilling at Pirkovskoe. Both the Pirkovskoe and Zagoryanska licenses are subject to disputes and the resolution of these are key to the valuation of these assets.

Pirkovskoe Production

We assume that Cadogan will develop the field using a two rig programme and that drill times will be c.10 months per well and that two wells per year will be achievable. This could improve if new western rigs were employed (Cadogan currently uses Ukrainian rigs) and, if so, the drilling time per well could halve. We believe that new wells will produce 720 boepd initially, in line with company guidance and with existing wells on the field. Under our assumptions production will average 2.1kboepd for 2009, rising by approximately 2kboepd per year to a plateau rate of c.13kboepd by 2016. We model the full value of cash flows on the basis that Cadogan is awarded a production license for the field. However, to mitigate this risk, we assume a government back-in of 30% and apply a WACC of 16% over the field. We believe the field will be cash flow positive in 2010 under our current assumptions.

Zagoryanska and Bitlyanska Development

The company is targeting the conversion of contingent resources in both the Zagoryanska (18.5 mn boe) and Bitlyanska licenses (302 mn boe). The Zagoryanska field is located adjacent to Pirkovskoe, which makes the economics of its development more attractive, as production can be tied back to existing processing facilities. Currently one well (Zag-3) is being drilled on the field, with two further workovers (Zag-2 and Zag-8) planned subsequently. After this activity and contingent on successful conversion of reserves, we believe that drilling can recommence (cash flow permitting) in 2011, and a two well per year programme can deliver production peaking in 2014 at 7kboepd. The Bitlyanska license comprises two fields, Borynya (188 mn boe) and Bitlya (114 mn boe). Both fields will be subject to appraisal drilling in 2009. We anticipate Borynya-3 in 2Q09 and Bitlya in 4Q09.

Exhibit 17: Multitude of operational catalysts across coming 12 months

Q4 2008	Pokrovskoe 2- Production test result
	Pirkovskoe 460- commencement of commercial production
	Pirkovskoe 1- Production test result
	Zagoryanska 3- drilling and testing by end of Q4
Q1 2009	Zagoryanska 2 and 8- Workover of two existing wells and possible production
Q2 2009	
Q3 2009	Pokrovskoe 1- Production tests and possible commencement of commercial production
	Submission of FDP for Pirkrovskoe Field

Source: Goldman Sachs Research estimates.

License validity remains the key concern, but we don't see court rulings as the end

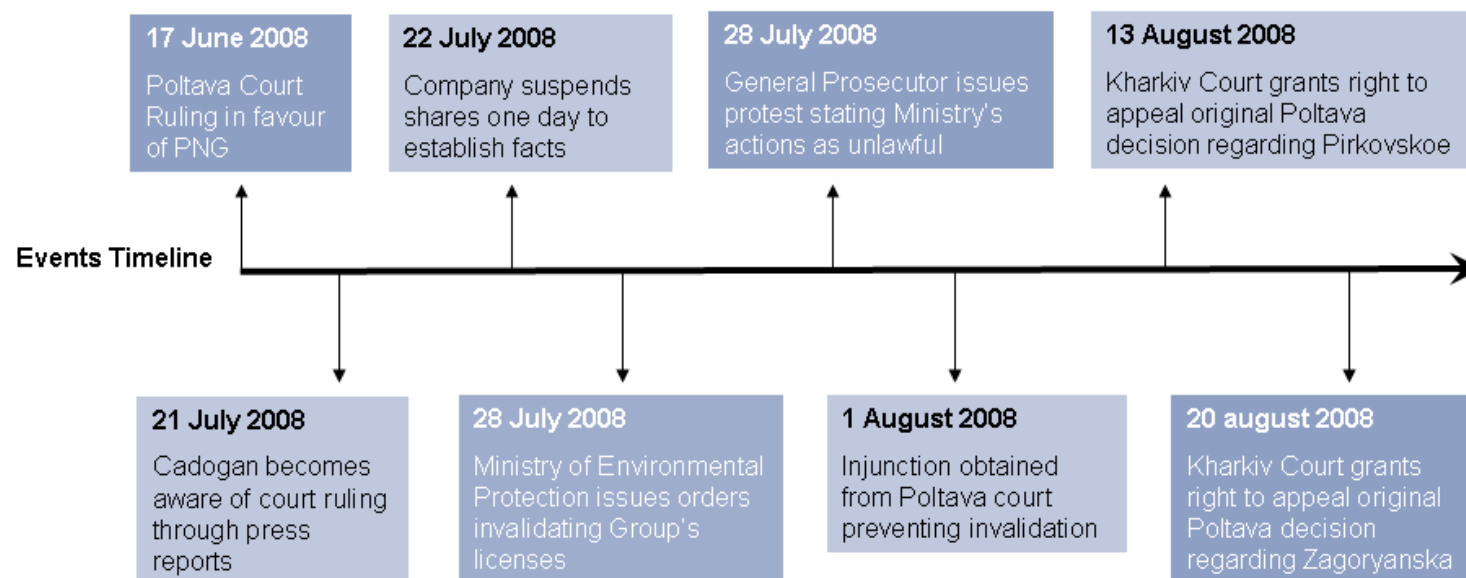
The current investment proposition is plagued by the issue of the Cadogan licenses for two reasons.

1. Court challenges remain over Pirkrovskoe and Zagoryanska licences.
2. Majority of Cadogan licenses only have "Exploration and Development" status.

Court Challenges on Pirkrovskoe and Zagoryanska

At the current time there are rulings outstanding in a local Ukrainian court that effectively invalidate the Pirkrovskoe and Zagoryanska licenses. While these rulings are being challenged by Cadogan, the two fields account for 42% of our SOTP-based price target. If Cadogan's appeal is not upheld, then both licences relating to these fields can be nullified. In this instance, our NAV would fall to 88p per share and deprive Cadogan of c.80 mn barrels of 2P reserves and c.19 mn barrels of contingent resources.

According to the company, on June 17, 2008, the Poltava Regional Commercial Court (PRGC, regional court within Ukraine) ruled in favour of Poltavanaftogazgeology (PNGC) in declaring a previous license transfer from PNGC to NJSC Nadra Ukraine invalid. The ruling related to the transfer of both the Pirkrovskoe and Zagoryanska licenses and has the potential to invalidate both licenses. On July 28, 2008 the Ministry of Environmental Protection issued orders invalidating the licenses. The General Prosecutor of Ukraine subsequently issued a protest stating the Ministry's actions were unlawful. On August 1, 2008, Cadogan obtained an interim injunction against the nullification of both licenses and is now due to challenge the original rulings of the PRGC ruling at a hearing on September 26, 2008 (having previously been scheduled for September 12, 2008).

Exhibit 18: Timeline of events surrounding license challenges

Source: Company data, Bloomberg

Licenses only have "Exploration and Development" status and expire within three years

The second issue is that the vast majority of the licenses that Cadogan holds are "Exploration and Development" licenses, which do not immediately entitle the holder to the rights to produce over the full life of the field. Upon submission of a Field Development Plan, Cadogan will apply for the transfer of the license in to full "Production" status, which would grant them the rights to the production from the field for 20-25 years.

Exhibit 19: Summary of Cadogan licenses

Majority of licenses expire by 2011

License Area	License Type	Product	Start Date	End Date	Working Interest of the Group
Pirkovskoe	Exploration & Development	Gas/Condensate	19-Oct-07	19-Oct-10	97.0%
Porkovskoe	Exploration & Development	Gas/Condensate	10-Aug-01	10-Aug-11	100.0%
Zagoryanska	Exploration & Development	Gas/Condensate	19-Oct-07	19-Oct-09	90.0%
Bitlyanska*	Exploration & Development		19-Oct-07	23-Dec-09	
Bitlya		Gas/Condensate			97.1%
Borynya		Gas/Condensate			96.5%
Vovchenska		Oil			96.8%
Monastyretske	Exploration & Development		19-Oct-07	23-Dec-09	
Monastyretske		Oil			95.0%
Blazhivskoe		Oil			95.0%
Krasnoyilske*	Exploration & Development	Gas/Condensate	19-Oct-07	23-Dec-09	98.5%
Debeslavetska	Exploration & Development	Gas/Condensate	07-Sep-01	07-Sep-11	98.3%
Debeslavetska	Production	Gas/Condensate	04-Oct-06	04-Oct-26	98.3%
Slobodo-Rungerske	Exploration & Development	Oil	11-Apr-01	11-Apr-11	100.0%
Cheremkhivskoe	Production	Gas/Condensate	14-May-02	14-May-18	49.8%
Malynovetska	Exploration & Development	Oil	11-Jan-02	11-Jan-12	79.9%
Mizhrichenska	Exploration & Development	Oil	07-Jun-06	07-Jun-06	40.0%

*Source: Company data.***Encapsulating risks into valuation**

We incorporate the risks surrounding the license renegotiation via two mechanisms. The first is to include a “company specific risk” weighting in our WACC of 500 bp. This takes our WACC to 16% vs. that of 11% for JKC and 12% for Regal Petroleum, the other Ukrainian operator. We also assume that the government will back into the company’s projects effectively taking a 30% equity interest once all upfront capital expenditure has been spent by Cadogan Petroleum. Catalyst for the removal of these two discounting mechanisms would be a ruling in Cadogan’s favour at the upcoming court hearings and the conversion of their “Exploration and Development” licenses to full “Production” licenses.

Exhibit 20: Ukrainian pure play with significant company specific risk

Cadogan Petroleum - Net asset value

Cadogan Petroleum							
	WACC	Risk	Reserves (mmboe)	NPV \$/bbl	NPV \$m	NPV £m	NPV p/s
Overheads and Corporate Liabilities					-88	-45	-19
Net Cash					271	143	62
Production + Financial Assets					183	98	42
Development Assets							
Pirkovskoe	16%	100%	79	2.4	189	110	48
			79		189	110	48
Core NAV					372	208	90
Appraisal & Exploration Assets							
Zagoryanska	16%	30%	30	2.6	23	13	6
Borynya	16%	30%	134	2.9	118	67	29
Bitlya	16%	30%	99	1.0	30	17	7
Pokrovskoe		20%	46	1.0	9	5	2
			263		172	98	42
Total NAV					543	306	132

Source: Company data, Goldman Sachs Research estimates.

Exhibit 21: Removing license specific risks more than doubles our current valuation

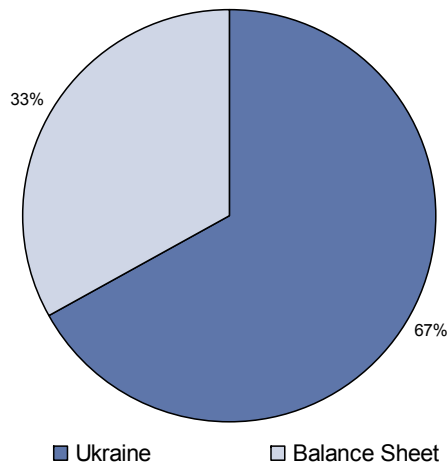
With an 11% WACC and assuming no government back-in implies a valuation of 273p/share

Cadogan Petroleum							
	WACC	Risk	Reserves (mmboe)	NPV \$/bbl	NPV \$m	NPV £m	NPV p/s
Overheads and Corporate Liabilities					-88	-45	-19
Net Cash					271	143	62
Production + Financial Assets					183	98	42
Development Assets							
Pirkovskoe	11%	100%	79	6.3	497	284	123
			79		497	284	123
Core NAV					680	382	166
Appraisal & Exploration Assets							
Zagoryanska	11%	30%	30	6.2	56	32	14
Borynya	11%	30%	134	6.9	276	156	67
Bitlya	11%	30%	99	3.7	109	62	27
Pokrovskoe		20%	46	3.7	34	19	8
			263		440	249	108
Total NAV					1120	632	273

Source: Company data, Goldman Sachs Research estimates.

Exhibit 22: Pure-play on Ukraine

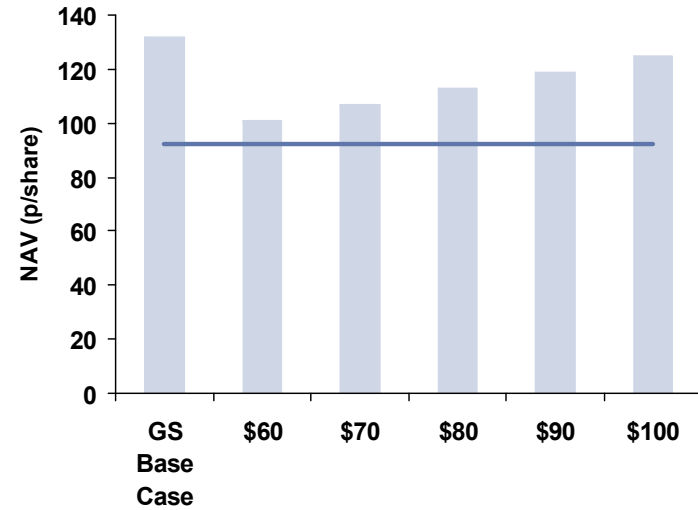
\$271 mn of cash on balance sheet to fund developments over next three years



Source: Goldman Sachs Research estimates.

Exhibit 23: Current share price implies oil price below \$60

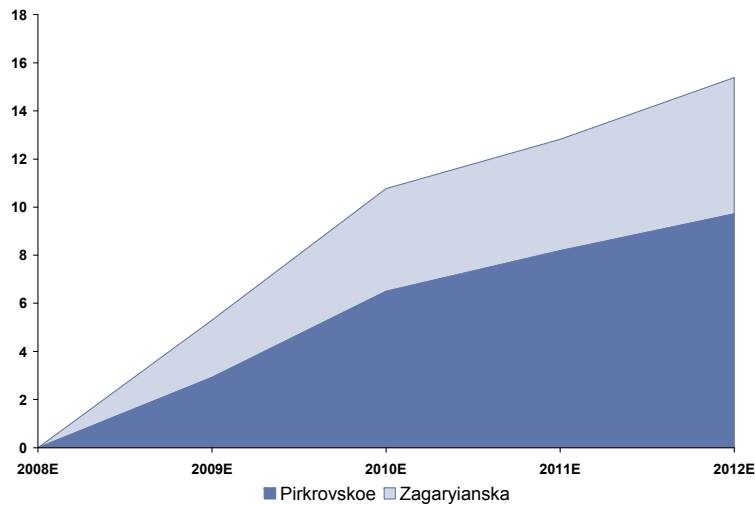
Note: Cadogan is more of a gas play and license issues distort this analysis



Source: Goldman Sachs Research estimates.

Exhibit 24: Production growth driven by Pirkovskoe field

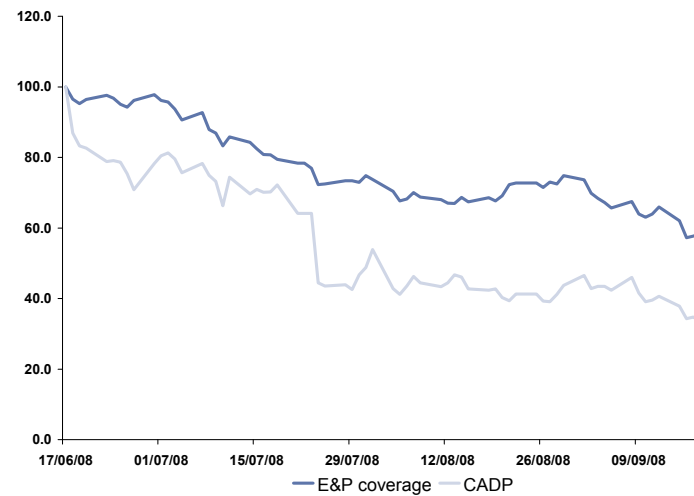
Profile enhanced if Zagoryanska development is successful



Source: Goldman Sachs Research estimates.

Exhibit 25: Cadogan Petroleum price performance vs. E&P Sector

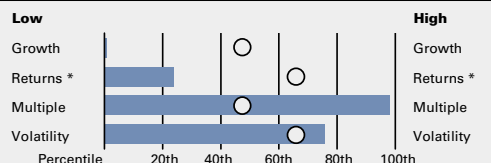
Since IPO, rebased



Source: Goldman Sachs Research estimates.

Heritage Oil (HOIL.L): Potential in those hard-to-reach places; initiate as Neutral

Investment Profile: Heritage Oil



■ HOIL.L

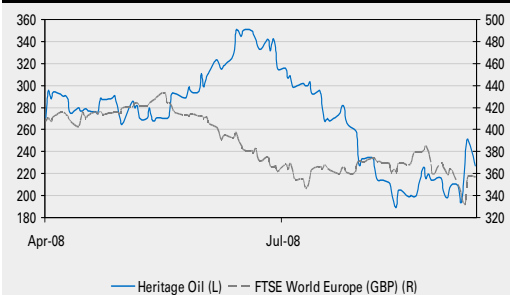
○ Europe Oil Services Peer Group Average

* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (p)	226.75
6 month price target (p)	317
Upside/(downside) (%)	40
Market cap (£ mn)	578.1
Enterprise value (\$ mn)	1,143.4

	12/07	12/08E	12/09E	12/10E
Revenue (\$ mn)	3.7	53.8	98.9	91.8
EBIT (\$ mn)	(47.8)	(1.1)	40.7	31.7
EPS (\$)	(0.25)	(0.03)	0.10	0.06
EV/EBITDA (X)	--	NM	26.5	34.7
P/E (X)	--	NM	41.9	68.2
Dividend yield (%)	--	NM	NM	NM
FCF yield (%)	--	(12.4)	(10.4)	(2.3)
CROCI (%)	--	(0.5)	2.4	(0.9)
CROCI/WACC (X)	--	--	--	--
EV/GCI (X)	--	4.1	2.9	2.7

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(35.2)	--	--
Rel. to FTSE World Europe	(30.7)	--	--

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/22/2008 close.

Investment view

Heritage has significant potential in its acreage in Uganda and Kurdistan, alongside a pipeline of potential exploration areas including Tanzania, Mali, DRC (Lake Albert) and Malta. Although projects in Russia and Oman should deliver modest production and cash flow in the medium-term, the value of these assets is relatively small in terms of the group's portfolio. We believe that the company is fully funded to the end of 2009, but believe that funds will be focused on appraisal drilling in Uganda and exploration in Kurdistan, rather than on development and production. After 2009, the company will be required to finance itself either by asset sale, debt finance or a return to the equity market. We note the recent announcement regarding the potential for an asset disposal or sale of the entire company, but do not see enough upside potential to be buyers of the stock. We initiate with a Neutral rating and a 317p, 6-month price target.

Core drivers of growth

Growth will likely be driven by drilling success in Uganda and Kurdistan. In 4Q08, we anticipate the drilling of four wells in Uganda, with a follow-up programme in early 2009. In Kurdistan, exploration drilling should commence at the Miran Block, with the potential for a follow-up well later in the year. We anticipate that production will increase next year to c.3kbpod, but as funds are allocated to Uganda and Kurdistan, we see natural decline in this profile beyond 2009E.

Risks to the investment case

The key risks to our view and price target on the downside are drilling and exploration failure in Uganda and Kurdistan, a fall in the oil price and an inability to refinance at the end of 2009. Fiscal renegotiation and political risk cannot be ignored; one of the company's producing assets is in Russia and their contract in Kurdistan (Northern Iraq) is not officially recognized by the Government of Iraq. On the upside, crystallisation of M&A activity and success at Uganda in particular could be a significant upside risk.

Valuation

We set our 317p, 6-month, price target based on a SOTP methodology including the discounted cash flow of the company's producing and near-term development assets and a risked assessment of its appraisal and exploration projects.

Heritage is highly levered to appraisal success in Uganda

Heritage Oil is an exploration and appraisal focused E&P company with a broad geographical spread of assets. The most significant asset in terms of value and size is their position in Uganda through 50% stakes in Blocks 1 and 3a in the Lake Albert basin. The company is partnered with Tullow Oil (TLW.L, Neutral) who have enjoyed considerable success in the basin over the past 12 months. Discussion on the potential of the Lake Albert basin has been considerable, though we don't want to spend time adding to the description of the asset in this piece. However, Heritage is highly geared to success in the basin as Uganda accounts for 92% of the company's value in our price target. As a result the fortunes of Heritage are highly geared to Uganda. In a "pure-success" case, our valuation would increase by 146% to 777p per share. Likewise, if we were to remove Uganda as a complete failure, our valuation would fall by 92% to 25p per share.

Significant volumetric potential in Kurdistan, but political and commercial hurdles exist

We assume 600 mn barrels of potential recoverable oil on the Miran Block given the wide STOIIP guidance and potential for wide ranges in recoverability experienced by Addax Petroleum at the Taq-Taq Field km North West of Miran. Although there have been no wells drilled on the block, we ascribe a 20% probability of success given the prospective nature of the region. However, the risks associated with Miran are not purely related to exploration. Located in the North of Iraq, the licenses that the Kurdistan Regional Government (KRG) granted have not been formally ratified by the Iraqi Government. While ratification of the licences could occur through negotiations between the KRG and Iraqi Government this cannot be guaranteed. However, a number of other independent operators including Addax Petroleum and DNO International are present in the region and KNOC (Korean National Oil Company) is reported to have agreed to invest significantly in the region according to reports from the KRG. Linked with political risk is the commercial risks around Kurdish oil. Currently there is no export route of meaningful scale. The most accessible option is to construct a pipeline to Kirkuk, and tie-in to the Kirkuk export pipeline. However, this solution is likely contingent on a political resolution to the oil contracts signed by the KRG.

As a consequence of the risks, we ascribe a WACC for the Miran Block in Kurdistan of 20%. We believe this adequately captures risk in a quantifiable way. If we were to ascribe a WACC of 12% our valuation of the Miran Block would increase by 95% from 17p/share to 33p/share. We estimate a "pure-success" case in Kurdistan for Heritage (assuming a 12% WACC) would be worth 321p/share.

Production growth constrained by capital allocation decisions

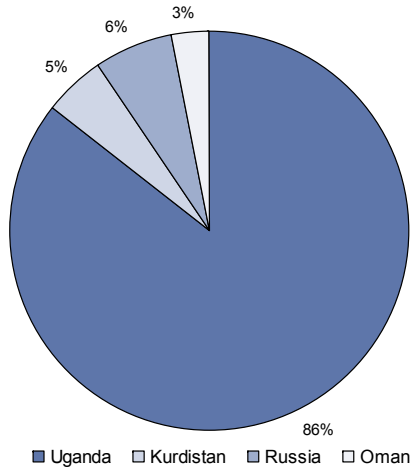
The group has 60 mn barrels of 2P reserves at Zapadno Chumpasskoye in Western Siberia. Although the reserve potential would suggest production could peak as high as 16k bopd in 2012, we do not believe the project will be a priority in the Heritage portfolio. We estimate that \$140 mn of capital expenditure needs to be spent to 2010 and more development drilling required beyond 2010. Given the groups current level of funding, we believe cash will be diverted towards projects in Kurdistan and Uganda and development of Zapadno Chumpasskoye will only occur if debt finance can be obtained or the company can farm-out a portion of the field.

Exhibit 26: Active drilling campaigns in Uganda and Kurdistan

Q4 2008	Uganda, Block 1- 3 well exploration campaign. Uganda, Block 3a- Kingfisher-3 appraisal well.
Q1 2009	Kurdistan, Miran Block- Exploration well
Q2 2009	Uganda, Block 1- Commencement of follow-up appraisal/ exploration campaign
Q3 2009	Kurdistan, Miran Block- Follow-up Exploration/Appraisal well
Q4 2009	Uganda, Block 3a- 1 well offshore Lake Albert. Crane or Pelican Prospect.

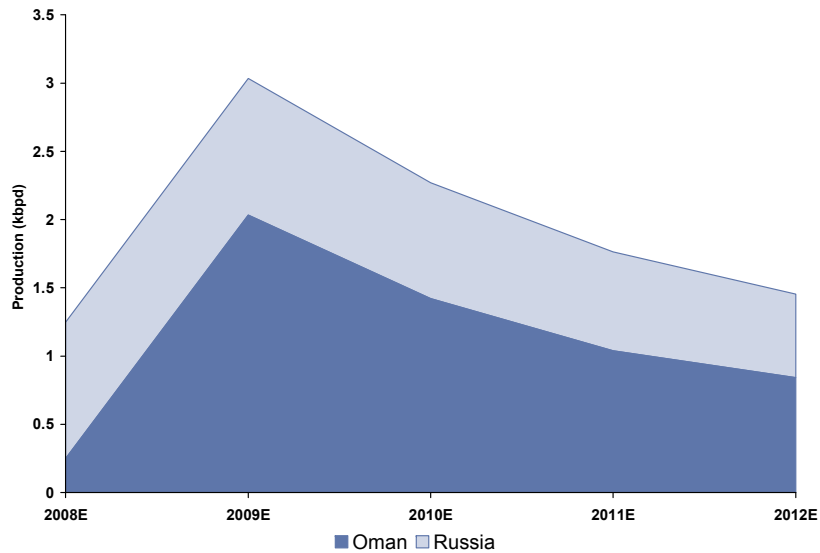
Source: Company data, Goldman Sachs Research estimates.

Exhibit 27: Significant leverage to success of appraisal in Uganda
Kurdistan could provide further upside when drilling commences in 2009



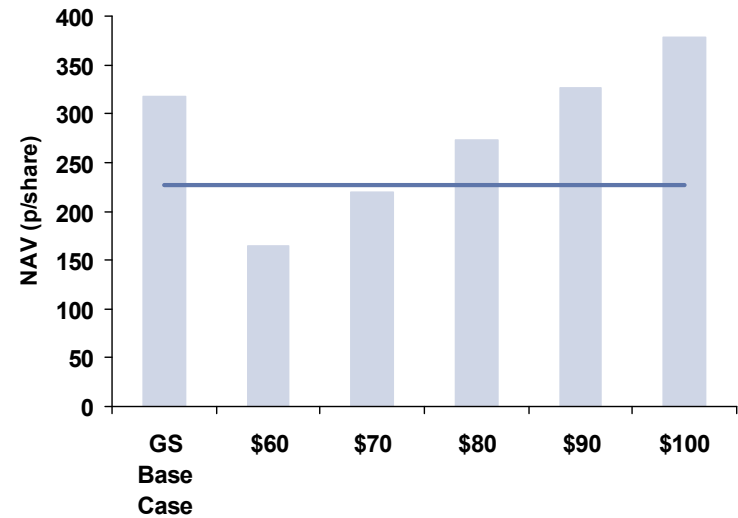
Source: Goldman Sachs Research estimates.

Exhibit 29: Production growth constrained; Ugandan appraisal the focus
Successful development could more than double plateau production level.



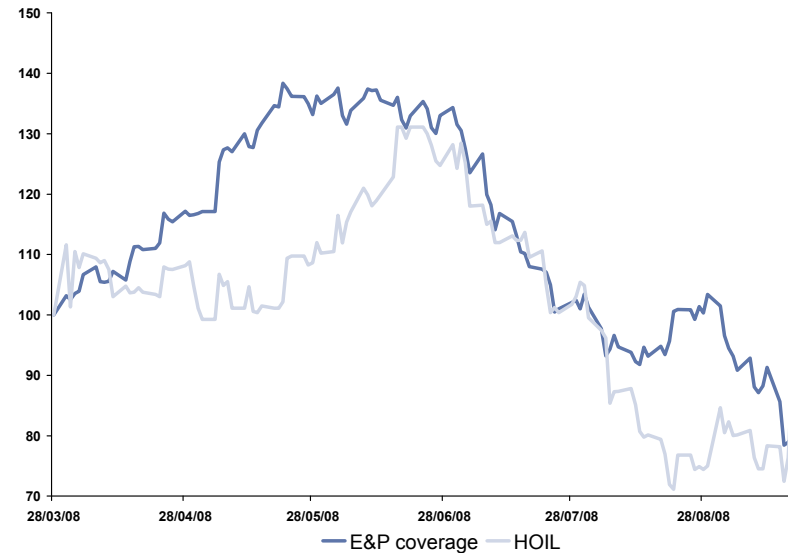
Source: Goldman Sachs Research estimates.

Exhibit 28: Current share price implies oil price of c.\$72
Leverage to oil price due to value of Ugandan project at different oil prices



Source: Goldman Sachs Research estimates.

Exhibit 30: Heritage Oil's price performance since IPO
Performance vs. E&P coverage since IPO



Source: Goldman Sachs Research estimates.

Exhibit 31: Valuation highly levered to Uganda, but cash flow provided from Oman and Russia operations

Heritage Oil - Net asset value

Heritage Oil Ltd							
Financial Assets	WACC	Risk	Reserves (mboe)	NPV \$/bbl	NPV \$m	NPV £m	NPV p/s
Financial Liabilities					-244.3	-128.6	-51
Net Cash					127.3	67.0	27
Production + Financial Assets					-117.0	-61.6	-24
Development Assets							
Oman- Block 8			3	14.4	44	25	10
Russia- Zapadno Chumpasskoye			64	1.5	98	56	22
			67		142	81	32
Core NAV			67		25	19	8
Exploration and Appraisal Assets							
Uganda- Block 1	11%	35%	554	4.2	818	431	171
Uganda- Block 3a	11%	46%	300	4.2	580	305	121
Kurdistan-Miran Block- Structure 1	20%	10%	600	1.3	81	42	17
			1454		1479	348	309
Total NAV			1521		1504	367	317

Source: Goldman Sachs Research estimates.

Exhibit 32: JKX and Regal Petroleum: Price target changes, methodology and risks

	TP (new)	TP (old)	Time horizon	Methodology	Risks
JKX Oil and Gas	549p	578p	6 months	SOTP	Oil and gas price increase/decrease. Development and exploration success/ failure. Political risk in Ukraine and fiscal renegotiation.
Regal Petroleum	243p	344p	12 months	SOTP	Oil and gas price increase/decrease. Development and exploration success/ failure. Political risk in Ukraine and fiscal renegotiation.

Source: Goldman Sachs Research estimates.

Reg AC

I, Franklin Walding, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

Quantum

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There are no company-specific disclosures for: Cadogan Petroleum PLC (92.25p)

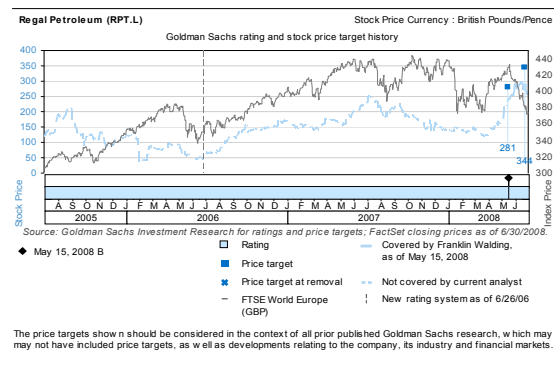
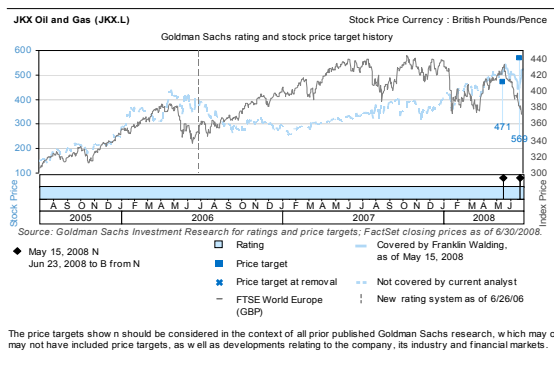
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Price target and rating history chart(s)



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