

7 April 2011

Gulfsands Petroleum

Year End	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/09	84.4	33.7	28.3	0.0	18.6	N/A
12/10	115.6	49.4	40.8	0.0	12.3	N/A
12/11e	151.2	82.1	67.3	0.0	7.8	N/A
12/12e	143.5	73.6	60.4	0.0	8.7	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items. \$1.62/£.

Investment summary: Driving up reserves

2010 results show Gulfsands Petroleum continuing to offer excellent reserves-driven upside through both careful reservoir management and exploration. By controlling reservoir conditions the company has grown Syrian underlying reserves by 26%. Six 2011 exploration and appraisal wells provide a range of upside options while costs are kept low due to attractive fiscal terms. The Sidi Daher well onshore Tunisia is due to spud in Q211 offering portfolio diversification. Meanwhile an expected licence round announcement in Syria could offer more potential acreage for Gulfsands' experienced Syrian drilling team.

Syria: Field performance boosts reserves growth

Excellent field performance at Khurbet East and Yousefieh continues to underpin Gulfsands assets in Syria, with underlying 2P reserves increasing 26% on a production-adjusted basis. A full exploration programme is in the pipeline to drill up remaining prospects ahead of the exploration licence expiry date of August 2012. The programme has yet to achieve success, but with six wells planned for 2011, there are plenty of potential catalysts to provide upside. Recent political unrest in the country has had no impact on operations or production export.

Tunisia: Exploration drilling near term

The company is due to drill its first onshore well in Tunisia on the Sidi Daher prospect in Q211. Success here would provide Gulfsands the opportunity to grow in a new area in keeping with its Syrian assets, with quick commercialisation possible due to proximity to existing infrastructure.

Valuation: 10% premium with 30% RENAV upside

Gulfsands' share price has come off in recent months, most likely as a result of uncertainty surrounding Middle East unrest. With operations unaffected and significant reserves driven progress we consider the company's core NAV now more than underpins the current share price. Six new wells in 2011 in Syria and Sidi Daher in Tunisia provide the upside driving our RENAV up to 430p.

Price 302p
Market Cap £368m

Share price graph



Share details

Code GPX
Listing AIM
Sector Oil & Gas
Shares in issue 122m

Price

52 week High 401p Low 244p

Balance Sheet as at 31 December 2010

Core NAV (p) 332
RENAV (p) 430
Net cash (\$m) 81

Business

Gulfsands Petroleum is involved in the production, exploration and development of oil and gas reserves in Syria, the US, Tunisia and Iraq.

Valuation

	2010	2011e	2012e
P/E relative	116%	75%	92%
P/CF	8.6	6.1	5.8
EV/Sales	4.4	3.3	3.6
ROE	27%	31%	21%

Geography based on revenues (2010)

UK	Europe	US	Other
0%	0%	14%	86%

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Driving reserves on multiple fronts

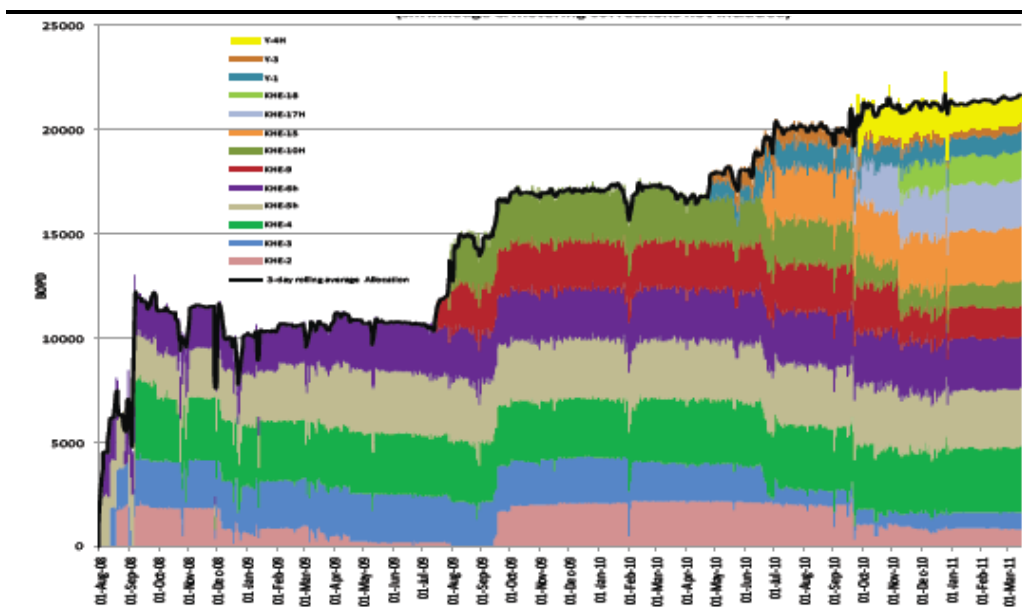
Gulfsands Petroleum's key assets, the producing Khurbet East and Yousefieh fields, continue to provide strong cash flow, while the continuing absence of water production from both fields has allowed reserves estimates to increase as low end models can be discounted. There are several opportunities for catalysts in the near term, with six exploration and appraisal wells planned in 2011 as part of the company's aggressive drilling schedule designed to drill up as many prospects as possible prior to its exploration licence expiring in August 2012.

Strong production performance drives reserves increase

Production from the Khurbet East and Yousefieh fields continues to perform well, with gross rates of 18,000bopd from Khurbet East and 3,000bopd from Yousefieh being achieved by year end 2010. Both fields are currently capacity constrained, however a new Central Processing Facility (CPF) is planned to be on-stream by Q412 which will allow production to increase to 33,000bopd. In the meantime, pipeline upgrades at the Khurbet East Early Production Facility (EPF) in 2011 will increase capacity here to 21,000bopd, giving a combined fields rate of 24,000bopd. The CPF will also be able to handle water production, which will be necessary once water breakthrough occurs in the fields.

Exhibit 1: Gulfsands Block 26 production to date

Note: Block 26 fields' gross production by well measured via test separator at Khurbet East EPF (shrinkage and metering corrections not included).



Source: Gulfsands Petroleum

Prudent reservoir management strategies have allowed Gulfsands to limit water production from the wells prior to CPF start up. Off-take from each of the production wells has been limited in order to minimise pressure drop at the reservoir, which reduces the chance of water being produced. The absence of water to date and the minimal pressure loss from initial reservoir conditions after producing over 12mmboe has eliminated some of the downside scenarios on field size and been the driver behind the latest increase in field reserves. The company's latest audited reserves update has booked net working interest 2P reserves of 53.6mmboe by end 2010, representing a 17%

increase over end 2009. Adjusting for net production of 3.3m mboe this constitutes a 26% increase in remaining 2P reserves.

There is also potential for further upgrades as a result of the company's 2011 development drilling programme. After the 2010 success of KHE-18 drilled to delineate the north-west flank of the Khurbet East field, two further wells, KHE-19 and KHE-20, will test this promising structural trend further. KHE-19 will be drilled in Q211 and will test 30m mboe of possible (3P) oil in place.

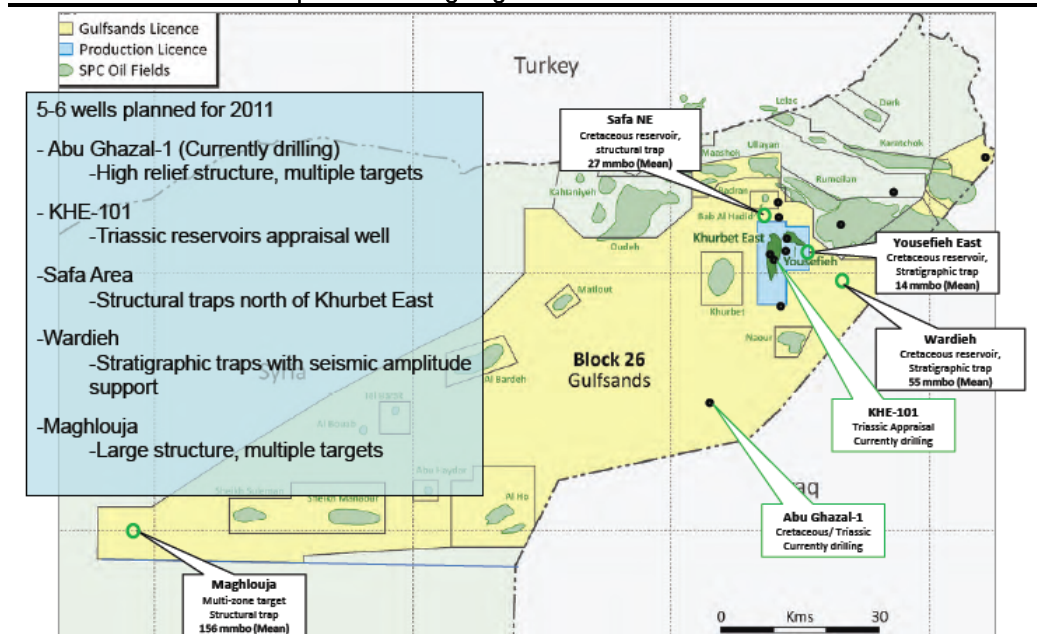
Depending on the outcome of this well, KHE-20 will be drilled to the north or east of the KHE-19 location.

As per the current Khurbet East and Yousefieh development plans a further 11% of recoverable oil will be produced after the expiry of the field production licences (February 2043 for Khurbet East and January 2045 for Yousefieh). As such these volumes are not currently classified as reserves. Gulfsands, however, intends to accelerate production at a later date in order to produce these reserves within the licence dates. It is expected that this will be achieved using infill drilling and Enhanced Oil Recovery (EOR) techniques.

Exploration push to maximise upside acreage

With its exploration licence in Syria due to expire in August 2012, Gulfsands needs to drill all of its exploration prospects within the next 16 months. To achieve this, the company brought in a second rig in 2010 and drilled five exploration wells in 2010, with plans to drill a further five or six wells in 2011. None of the 2010 wells encountered commercial hydrocarbons. This should not affect the success of the upcoming exploration programme, however, as the prospects are all very different, targeting a range of reservoirs and trap types.

Exhibit 2: Block 26 2011 exploration drilling targets



Source: Gulfsands Petroleum

Two wells are currently being drilled as follows.

- **KHE-101:** This appraisal well is being drilled to assess the deeper Triassic aged reservoirs, Butmah and Kurrachine Dolomite, which were encountered in the original KHE-1 discovery well. The principal hydrocarbon target is likely to be gas, although there is the possibility the reservoir can also be oil bearing. Mean estimated resources for KHE-101 are in the region of 25bscf.
- **Abu Ghazal:** This fault bound structure is located approximately 30km south-east of Khurbet East and as such is one of the more remote wells Gulfsands is drilling on Block 26. The company is targeting a mean resource estimate of 50mmbob in both the Cretaceous Massive and again in the deeper Triassic Butmah and Kurrachine Dolomite reservoirs (like with KHE-101). Results from this well are expected to be announced by the end of April 2011.

The remaining exploration wells planned in Syria for 2011 are as follows.

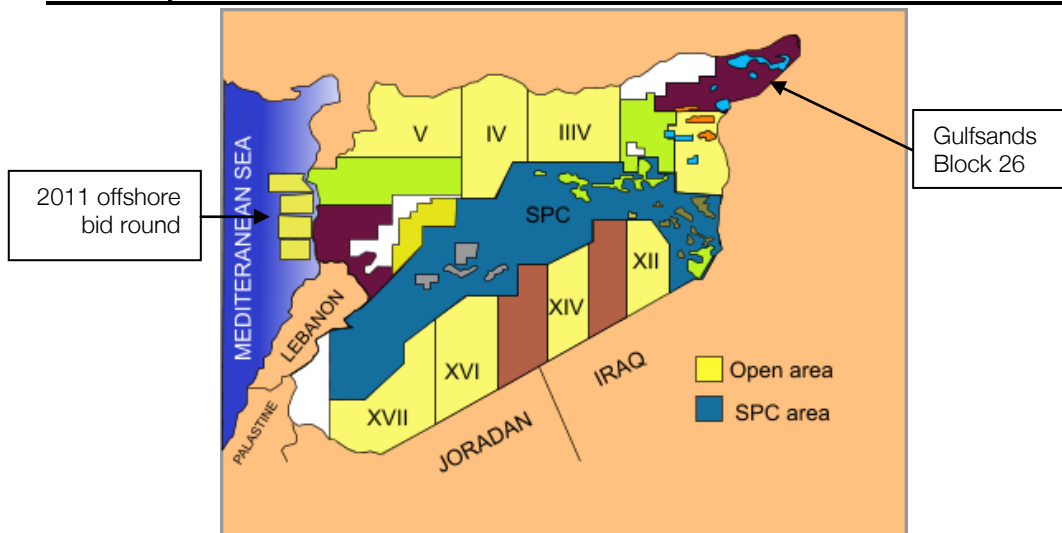
- **Yousefieh East:** This well will test a structural high to the east of the Yousefieh field. The Cretaceous age reservoir here is similar to the Yousefieh field, with mean resource estimate of 14mmbob. The exploration well here is due to spud late Q211 using rig 401 once it has been freed from drilling Abu Ghazal.
- **Safa:** This prospect, located less than 10km north of Khurbet East, is targeting a similar Cretaceous reservoir, with a mean resource estimate of 27mmbob. The fault bound dip closures here are on trend with the Khurbet East field and, being in close proximity to the Khurbet East CPF under construction, a successful discovery could readily be commercialised through a tie-back to the processing facility. Safa is expected to be the first exploration target to be drilled with rig 501 after the KHE-101 appraisal well, with a target spud date towards the end of Q211.
- **Wardieh:** This prospect, approximately 15km east of Khurbet East, is targeting a mean resource estimate of 55mmbob in a Cretaceous reservoir with stratigraphic trap similar to that found in Yousefieh. If exploration drilling is successful we would expect Wardieh to still be commercial as a tie-back to the Khurbet East CPF. Drilling here is expected to start in Q311.
- **Maghlouga:** This is a large structure located at the south-east edge of Gulfsands' Block 26 permit and approximately 120km away from Khurbet East and the surrounding production and exploration prospects. As such any development at Maghlouga is likely to be on a standalone basis. However, the prospect is large with both robust, fault bound closure and multiple reservoir targets in both the Triassic and Palaeozoic targeting mean resource estimates of 156mmbob. Maghlouga is expected to be drilled in Q411.

In order to maintain the flow of exploration wells for the rest of 2011 and 2012, Gulfsands is also processing 1,070km² of 3D seismic which should be available by mid-2011.

Syria onshore licence round may offer new acreage

With its Block 26 exploration licence in Syria due to expire in August 2012, Gulfsands has its hands full for now in pursuing multiple exploration targets. However, the company is also bidding in the latest Syrian onshore licence round, along with international and national oil companies such as Royal Dutch Shell, Total, China National Petroleum Corporation, Tatneft and ONGC Videsh.

Exhibit 3: Syria onshore and offshore blocks



Source: Syria Petroleum Corporation

No announcement has been made public but we understand licences are likely to be awarded sometime in the near future. Gulfsands' longer-term exploration outlook within Syria will clearly be affected by how successful it is in this licence round.

The Syrian authorities have also recently invited bids for the latest offshore licence round. However, the closing date for this round is 5 October 2011 so successful applications are not likely to be known here until early 2012.

Tunisian exploration imminent

Gulfsands is due to commence drilling on its Sidi Daher prospect in the onshore Tunisian Chorbane licence in Q211. The mobilisation of the rig to the well site has been delayed in response to the recent political situation in Tunisia. However, operator ADX Energy has stressed that this is to ensure the availability of government officials and local police to assist in the smooth running of the operation, rather than due to any unrest in the area. The Sidi Daher prospect has a mean resource estimate of 70mmbob, and, if successful, can easily be tied into existing infrastructure. This acreage provides the potential for the company to grow into an area in keeping with its existing assets.

The company also holds the offshore Kerkouane licence in Tunisia, which extends into the Italian Pantelleria licence with the Lambouka well being drilled on the Kerkouane/Pantelleria border in 2010. Although hydrocarbons were identified on the logs, the hole condition deteriorated to the point that it was not possible to obtain a fluid sample or test the well. An appraisal well/sidetrack is possible in 2011. However, at the moment there are no immediate plans to do so.

The nearby Dougga discovery in the Kerkouane licence has a mean gas initially in place (GIIP) of 618bscf and has potential development synergies with Lambouka. An appraisal well is being planned here but is not likely to be drilled until at least 2012.

Valuation: 332p core NAV with extensive upside

Gulfsands is currently trading at approximately a 10% discount to our core NAV of 332p. This is based solely on established production at Khurbet East and Yousefieh along with the company's minority non-operated interests in the Gulf of Mexico.

With 53.6mmboe of net working interest 2P reserves, the two Block 26 producing fields, Khurbet East and Yousefieh, are the main valuation drivers. Underlying reserves for these two fields, after adjusting for production depletion, have increased 26%. These two projects are considered extremely robust with continued valuation increases likely as Gulfsands proves up additional reserves through both appraisal drilling and reservoir management.

Exhibit 4: Gulfsands valuation

FD shares (million)	121.9									
\$/£	1.6									
Assets	Country/ Licence	WI %	Hydroc. Fluid	Net Capex \$m	CoS %	Unrisked Reserves/Resources		Netback NPV/boe	EMV \$m	Value/sh p
						Gross mmboe	Net (WI) mmboe			
Developed										
US	US		Oil-Gas		100%		3.3	3.2	11	5
Khurbet East	Syria	50%	Oil		100%	83.9	41.9	13.1	547	281
Yousefieh	Syria	50%	Oil		100%	23.4	11.7	7.5	87	45
						Total	56.9		Total	331
Cash/(Net Debt)									85	43
G&A									(83)	(43)
Core NAV									Total	332
Exploration/Appraisal										
KE appraisal upside	Syria	50%	Oil	0.5	25%	30.0	15.0	13.1	49	25
Khurbet East Deep	Syria	50%	Gas	1.1	50%	4.2	2.1	7.5	7	4
Abu Ghazal	Syria	50%	Oil	1.1	23%	50.0	25.0	4.0	22	11
Safa NE	Syria	50%	Oil	0.5	23%	27.0	13.5	6.0	18	9
Wardieh	Syria	50%	Oil	0.5	23%	55.0	27.5	5.0	31	16
Maghlouga	Syria	50%	Oil/Gas	1.8	10%	156.0	78.0	3.0	22	11
Yousefieh East	Syria	50%	Oil	0.5	23%	14.0	7.0	7.0	11	5
Chorbane	Tunisia	40%	Oil	4.8	23%	70.0	28.0	6.1	34	18
						Total	196		Total	99
RENAV									Total	430

Source: Edison Investment Research

Driving the risked exploration net asset value upside (RENAV) is mainly the Block 26 exploration and appraisal programme described earlier. The Khurbet East appraisal upside focuses on further delineation of the Khurbet East field with potential to move an additional 30mmboe of possible reserves into proved plus probable. The remaining Block 26 assets are included based on both the geological/exploration chance of success and potential netbacks given each field's complexity and likely development and operating costs.

Within the Tunisian portfolio we include the potential upside from successful drilling of the Sidi Daher prospect on the Chorbane permit. We do not, however, include any impact of the Lambouka/Dougga discovery given the marginal economics associated with these fields at present. We understand further discussions are likely with Tunisian authorities regarding fiscal terms before any final drill decision is taken.

Syria exploration and appraisal along with Chorbane adds an additional 99p to our valuation giving a RENAV of 430p, reflecting the significant upside potential in the share price.

Sensitivities: Upside robust down to \$50/bbl

Our valuation is based on \$80/bbl real oil prices with a short-term forecast of \$98.5/bbl in 2011 and \$90/bbl in 2012. We apply a discount rate of 10% reflecting the extremely strong balance sheet and relatively low cost of drilling in Syria.

Exhibit 5: Gulfsands valuation sensitivities, core NAV and RENAV

Core NAV (\$/bbl)	Discount rate (%)					RENAV (\$/bbl)	Discount rate (%)				
	7.5%	10%	12.5%	15%	17.5%		7.5%	10%	12.5%	15%	17.5%
40	202	185	172	162	153	40	284	264	248	235	225
60	289	258	235	216	201	60	383	347	319	297	279
80	376	332	297	271	249	80	483	430	390	359	334
100	464	405	360	325	297	100	582	514	462	421	388

Source: Edison Investment Research

Exhibit 5 shows our valuation sensitivities to both oil price and discount rate. Given the current share price our core NAV valuation remains robust with a long range oil price outlook as low as \$70/bbl, while a Brent assumption of only \$50/bbl would be required to reduce our RENAV to the current share price. Both of these are clearly well below both recent historical averages and current oil prices in excess of \$100/bbl.

Financials: Fully funded for all E&P

This week's annual results summarise Gulfsands' exceptional progress in both building its operations base and in managing the financial strength of the business.

With Syrian working interest production up 47%, this has driven revenues up 37% to \$116m and profit after tax up 58% to \$45m (\$50m on a normalised basis). Syria lifting costs are down to \$1.9/bbl from \$2.3/bbl in 2009, while finding costs (inception to date) are impressively low at only \$0.8/bbl.

The end year net cash position was a healthy \$81m, with latest company estimates indicating free cash in excess of \$100m. Debt free, Gulfsands is fully funded both to complete construction of its new €94m gross central processing facility (due to commission end 2012) and for all exploration and appraisal drilling over the next two years. We continue to forecast \$92m net cash at end 2011 and \$85m at end 2012, demonstrating the strength of the company. Cash from operations was up 61% to \$70m in 2010 and we forecast this is likely to grow a further 40% in 2011 before levelling off in 2012 as Khurbet East and Yousefieh production remains rate limited prior to commissioning of the CPF.

The US asset base remains non-core and Gulfsands expects to dispose of its remaining assets in this area subject to market conditions. We expect a further approximately \$10m of cash could be added to reserves when disposal of the remaining US assets is eventually completed.

Exhibit 6: Financials

	\$'000s	2008	2009	2010	2011e	2012e
Year end 31 December						
PROFIT & LOSS						
Revenue		53,600	84,415	115,578	151,249	143,546
Cost of Sales		(17,567)	(19,250)	(17,954)	(18,350)	(17,628)
Gross Profit		36,033	65,165	97,624	132,899	125,918
EBITDA		7,864	47,270	67,367	105,583	97,982
Operating Profit (before GW and except.)		(487)	34,489	50,325	82,648	74,189
Exceptionals		(6,384)	(5,882)	(4,788)	0	0
Operating Profit		(6,871)	28,607	45,537	82,648	74,189
Other		(1,667)	(1,056)	(1,113)	(1,084)	(1,084)
Net Interest		1,229	293	228	495	481
Profit Before Tax (norm)		(925)	33,726	49,440	82,059	73,586
Profit Before Tax (FRS 3)		(7,309)	27,844	44,652	82,059	73,586
Tax		1,932	(12)	18	0	0
Profit After Tax (norm)		1,007	33,714	49,458	82,059	73,586
Profit After Tax (FRS3)		(5,377)	27,832	44,670	82,059	73,586
Average Number of Shares Outstanding (m)		115.6	119.3	121.1	121.9	121.9
EPS - normalised (c)		0.9	28.3	40.8	67.3	60.4
EPS - FRS 3 (c)		(4.7)	23.3	36.9	67.3	60.4
Gross Margin (%)		67.2%	77.2%	84.5%	87.9%	87.7%
EBITDA Margin (%)		14.7%	56.0%	58.3%	69.8%	68.3%
Operating Margin (before GW and except.) (%)		(0.9%)	40.9%	43.5%	54.6%	51.7%
BALANCE SHEET						
Fixed Assets		90,565	101,650	104,439	169,304	251,911
Intangible Assets		343	7,091	30,958	35,958	40,958
Tangible Assets		77,055	82,569	63,878	123,743	201,350
Investment in associates		0	0	0	0	0
Long-term financial assets		13,167	11,990	9,603	9,603	9,603
Current Assets		54,749	83,655	138,473	144,658	134,164
Stocks		2,401	4,165	4,002	5,237	4,970
Debtors		15,536	21,867	35,559	46,534	44,164
Cash		36,812	57,623	80,625	92,887	85,030
Other		0	0	18,287	0	0
Current Liabilities		(17,122)	(17,094)	(39,222)	(29,767)	(28,827)
Creditors		(11,245)	(13,411)	(23,126)	(24,597)	(24,678)
Tax and social security		(5,877)	(3,683)	(7,473)	(5,171)	(4,149)
Short term borrowings		0	0	0	0	0
Provision for decommissioning		0	0	(8,623)	0	0
Long Term Liabilities		(20,430)	(27,937)	(20,683)	(16,596)	(13,530)
Deferred Tax Liabilities		0	0	0	0	0
Provision for decommissioning		(20,430)	(27,937)	(20,683)	(16,596)	(13,530)
Net Assets		107,762	140,274	183,007	267,599	343,718
CASH FLOW						
Operating Cash Flow		16,908	41,539	69,073	97,377	103,233
Net Interest		1,229	293	228	495	481
Tax		(524)	(66)	402	0	0
Capex		(19,292)	(24,966)	(48,635)	(95,273)	(111,571)
Acquisitions/disposals		0	455	1,100	9,664	0
Financing		19,958	3,556	3,218	0	0
Dividends		0	0	0	0	0
Other		0	0	(2,384)	0	0
Net Cash Flow		18,279	20,811	23,002	12,262	(7,857)
Opening net debt/(cash)		(18,533)	(36,812)	(57,623)	(80,825)	(92,887)
HP finance leases initiated		0	0	0	0	0
Other		0	0	0	0	0
Closing net debt/(cash)		(36,812)	(57,623)	(80,625)	(92,887)	(85,030)

Source: Edison Investment Research, company accounts

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