

14 May 2009

## Gulfsands Petroleum

Year End	Revenue (\$m)	PBT* (\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/07	37.3	8.0	5.0	0.0	55.1	N/A
12/08	53.6	3.7	4.9	0.0	56.2	N/A
12/09e	67.4	18.5	13.3	0.0	20.1	N/A
12/10e	85.0	29.6	22.0	0.0	12.1	N/A

Note: \*PBT and EPS are normalised, excluding goodwill amortisation and exceptional items.

### Investment summary: Step-up at Khurbet

2008 was an exceptional year for Gulfsands with a strong underlying performance and revenues up 44% to \$53.6m. This is likely to improve further with Syrian production forecast to increase from its current 11,000bbl/d to 18,000bbl/d by Q309. Additional upside lies in the appraisal of Yousefieh and in potential new drilling targets from the processing of new 3D seismic on Block 26.

### Khurbet East: Progressing with development

The company is progressing with the development of Khurbet East. It recently announced the drilling of the horizontal KHE-9 well testing 3,040bbl/d, in addition to plans to expand the early production facility to 18,000bbl/d by Q309 with expected average production of 16,000bbl/d in H209. Yousefieh is also expected to come on-stream in 2009.

### Strong financial performance

Although in 2008 the company made a loss due to asset impairments and severance costs, Gulfsands reported a strong underlying performance driven by production from Khurbet East. Group revenues were up 44% to \$53.6m and operating cash flow grew from a modest \$5m in 2007 to \$18m. As Syrian production increases in the next couple of years, we expect a significant step-up in profitability with EPS of 13.3c and 22.1c in 2009 and 2010, respectively.

### Outlook: Still substantial upside in Syria

Major stock catalysts for this year are the 18,000bbl/d production milestone expected by Q309 and appraisal and first oil at Yousefieh. In addition the processing of new 3D seismic on Block 26 is due by Q409. This will allow the company to identify prospects to target in 2010. Given Gulfsands' exploration success, we believe this could turn into a significant 2010 stock catalyst with potentially two rigs on site – one for the development drilling and one for exploration.

### Valuation: Rising on reserves upgrade

Recently Gulfsands released a Competent Person's Report (CPR) update which revised 2P reserves upwards to 35.4mmbbl (WI) in Khurbet East, and determined for the first time Yousefieh net 2P reserves of 5.7mmbbl (WI). Based on this reserves revision, de-risking of Yousefieh and a more precise timing on the EPF expansion, we upgraded our core NAV from 125p to 169p and our RENAV from 147p to 206p.

Price 184.75p  
Market Cap £219m

#### Share price graph



#### Share details

Code GPX  
Listing AIM  
Sector Oil & Gas  
Shares in issue 119.1m

#### Price

52 week High 222p Low 94.3p

#### Balance Sheet as at 31 December 2008

Debt/Equity (%) N/A  
RENAV (p) 206  
Net cash (£m) 36.8

#### Business

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

#### Valuation

	2008	2009e	2010e
P/E relative	571%	198%	139%
P/CF	17.7	11.5	9.1
EV/Sales	5.3	4.5	3.5
ROE	5%	12%	17%

#### Geography based on revenues

	UK	Europe	US	Other
0%	0%	52%	48%	

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## Investment summary: Step-up at Khurbet East

Gulfsands is an AIM-listed E&P company with the potential to grow into a sizable independent in the short-to-medium term. The company is operating in two main areas, Syria and the US, and is also pursuing a mid-stream project (Maysan) in Iraq. Gulfsands' assets form a balanced portfolio of cash-generative fields in the mature area of the Gulf of Mexico combined with significant upside in Block 26 in Syria where the company operates with local technical staff.

Political risk is a key sensitivity, which the company has so far been able to manage. Due to the sanctions imposed by the US on Syria, the company is *de facto* running its two subsidiaries independently.

### Strategy

- Retain a Middle East focus;
- Maximise the potential of Block 26 (Syria);
- Make selective investments in the US;
- Develop a substantial business in Iraq in the medium-to-long term; and
- Maintain a strong balance sheet and cash-flow headroom.

### Sector positioning

In our sector report *Golden Barrels* we suggested five criteria to look for in companies that are likely to optimise shareholders' value in the junior oil and gas space: exploration-gearred upside; strong sub-surface understanding; efficient use of capital; an ability to balance risk and reward; and a focus on near-term drilling. We believe that Gulfsands has a balanced portfolio of mature cash generative assets in the US and exploration and development upside in Syria. This is supported by local technical staff in the US and Syria, a strong cash position of \$36.8m, producing assets and no debt.

### Key facts

- \$36.8m net cash as at December 2008.
- 2P reserves (WI) of 46 million barrels of oil equivalent (mmbob).
- Syrian 2009 production: c 7,000bb/d (working interest).
- Onshore low cost operations in Syria with substantial upside.
- Mid-stream project in Iraq.
- Debt-free.

### Near-term catalysts

#### Exhibit 1: Catalysts expected in 2009

Re-instatement of Eugene Island production	August 2009
Expansion of EPF to 18,000bb/d	Q309
Second appraisal well on Yousefieh (Y-3 well)	Q309
Processing of new 3D seismic	Q409
Yousefieh first oil	H209
Permanent production facilities	H110

Source: Gulfsands Petroleum, Edison Investment Research

## Management

In 2008 the company underwent a significant change in management with the resignation of the CEO and CFO. The resignations were provoked by the increasing importance of the Syrian assets to the company's operations and, therefore, the need to have its HQ located between its two core areas. New CEO Richard Malcolm was appointed in October 2008. Prior to this he held the position of UK director at OMV. New CFO Andrew Rose was previously finance director of Burren Energy, which was taken over by ENI in January 2008.

## Sensitivities

Given the nature and location of Gulfsands' asset portfolio, we believe that oil price and exploration risk is limited compared to its peers. Of greater importance is political risk, a key sensitivity that investors should consider. Although the company has good relationships with local authorities and the Syrian Petroleum Company, a conflict arises in connection with the US authorities, which have imposed sanctions against Syria and specifically against the owner of an investment fund with an equity interest in the company. As a result, its US subsidiary should currently be considered as standalone since it is unlikely that its cash flow could be used to finance Syrian assets and vice-versa. However, the new US administration seems to have a different approach and, in the future, sanctions could be lifted.

## Financials: Strong underlying performance

In 2008 Gulfsands made a loss at group level due to severance costs and share-based payments. However, underlying performance was strong in Syria with group revenues up 44% and cash flow from operations up over 200% y-o-y. This positive trend is expected to improve in 2009 and 2010 with revenues of \$67.4m and \$85.0m, and cash flow from operations of \$28.4m and \$35.9m, respectively.

## Valuation: Rising on reserve upgrade

In May Gulfsands released the results of a new reserves report which incorporated new geological results from KHE-8 and historical production from July 2008 and, for the first time, reserves for Yousefieh. The 2P reserves at Khurbet East have been revised upward from 29.3mmbbl to 35.4mmbbl on a working interest basis and from 11.3mmbbl to 14.3mmbbl on a net entitlement basis. Based on this reserves increase, de-risking of Yousefieh and the revised timing of the EPF expansion, we have upgraded our core net asset value (NAV) from 125p to 169p and our risked exploration NAV (RENAV) from 147p to 206p. The processing of seismic due in Q409 will probably lead to potential drilling targets at Block 26, which could add further value to our risked upside.

### Exhibit 2: Valuation

FD shares (m)		129.0				Unrisked						
\$/£		1.45				Reserves/Resources		Netback				
Assets	Country/ Licence	WI %	Hydroc. Fluid	CoS %	Gross mmboe	Net (WI/Ent) mmboe	NPV/boe \$/boe	EMV \$m	Value/sh p			
<b>Developed</b>												
USA	USA	2-53%		100%			9.2	51.0	27			
Khurbet East	Syria	50.0%	Oil	100%	70.4	14.3	18.2	260.7	139			
<b>Total</b>								<b>19.4</b>	<b>Total</b>	<b>167</b>		
Cash/(Net Debt)									36.8	20		
G&A									(31)	(16)		
Other									(2)	(1)		
<b>Core NAV</b>									<b>Total</b>	<b>169</b>		
<b>Exploration</b>												
Yousefieh	Syria	50.0%	Oil	80%	11.3	2.5	23.3	47.0	25			
K-Dolomite	Syria	50.0%	Oil	45%	3.4	0.7	18.2	4.5	2			
Butmah	Syria	50.0%	Gas	45%	11.5	2.3	18.2	17.7	9			
<b>Total</b>									<b>37</b>			
<b>RENAV</b>									<b>Total</b>	<b>206</b>		

Source: Edison Investment Research

**Exhibit 3: Financials**

	\$'000s	2007	2008	2009e	2010e
Year end 31 December					
<b>PROFIT &amp; LOSS</b>					
<b>Revenue</b>		<b>37,309</b>	<b>53,600</b>	<b>67,367</b>	<b>84,992</b>
Cost of Sales		(15,883)	(16,588)	(31,193)	(33,842)
Gross Profit		21,426	37,012	36,175	51,150
<b>EBITDA</b>		<b>14,222</b>	<b>19,250</b>	<b>23,425</b>	<b>38,900</b>
<b>Operating Profit (before GW and except.)</b>		<b>8,241</b>	<b>4,156</b>	<b>18,602</b>	<b>29,867</b>
Share based payments		(882)	(12,572)	(1,000)	(1,000)
Exceptionals		(1,856)	(2,750)	0	0
<b>Operating Profit</b>		<b>5,503</b>	<b>(11,166)</b>	<b>17,602</b>	<b>28,867</b>
Other		(1,475)	(1,667)	(1,084)	(1,225)
Net Interest		1,190	1,229	1,000	1,000
<b>Profit Before Tax (norm)</b>		<b>7,956</b>	<b>3,718</b>	<b>18,519</b>	<b>29,642</b>
<b>Profit Before Tax (FRS 3)</b>		<b>5,218</b>	<b>(11,604)</b>	<b>17,519</b>	<b>28,642</b>
Tax		(2,557)	1,932	(2,725)	(3,445)
<b>Profit After Tax (norm)</b>		<b>5,399</b>	<b>5,650</b>	<b>15,794</b>	<b>26,197</b>
<b>Profit After Tax (FRS3)</b>		<b>2,661</b>	<b>(9,672)</b>	<b>14,794</b>	<b>25,197</b>
Average Number of Shares Outstanding (m)		107.2	115.6	119.1	119.1
<b>EPS - normalised (c)</b>		<b>5.0</b>	<b>4.9</b>	<b>13.3</b>	<b>22.0</b>
<b>EPS - FRS 3 (c)</b>		<b>2.5</b>	<b>(8.4)</b>	<b>12.4</b>	<b>21.2</b>
Gross Margin (%)		57.4%	69.1%	53.7%	60.2%
EBITDA Margin (%)		38.1%	35.9%	34.8%	45.8%
Operating Margin (before GW and except.) (%)		22.1%	7.8%	27.6%	35.1%
<b>BALANCE SHEET</b>					
<b>Fixed Assets</b>		<b>75,518</b>	<b>93,171</b>	<b>124,659</b>	<b>142,126</b>
Intangible Assets		28,593	343	69,168	82,372
Tangible Assets		46,925	79,661	55,491	59,754
Investment in associates		0	0	0	0
Long-term financial assets		0	13,167	0	0
<b>Current Assets</b>		<b>45,765</b>	<b>54,749</b>	<b>43,797</b>	<b>52,197</b>
Stocks		0	2,401	0	0
Debtors		11,154	15,536	16,695	18,695
Cash		34,611	36,812	27,102	33,502
Other		0	0	0	0
<b>Current Liabilities</b>		<b>(9,184)</b>	<b>(17,122)</b>	<b>(18,318)</b>	<b>(20,818)</b>
Creditors		(9,184)	(11,245)	(15,318)	(17,318)
Other creditors		0	(5,877)	(3,000)	(3,500)
Short term borrowings		0	0	0	0
Minority interests		0	0	0	0
<b>Long Term Liabilities</b>		<b>(11,407)</b>	<b>(20,430)</b>	<b>(21,326)</b>	<b>(22,495)</b>
Long term borrowings		0	0	0	0
Other long term liabilities		(11,407)	(20,430)	(21,326)	(22,495)
<b>Net Assets</b>		<b>100,692</b>	<b>110,368</b>	<b>128,812</b>	<b>151,010</b>
<b>CASH FLOW</b>					
<b>Operating Cash Flow</b>		<b>4,955</b>	<b>17,996</b>	<b>28,425</b>	<b>35,900</b>
Net Interest		1,190	1,229	1,000	1,000
Tax		(356)	(524)	(300)	(2,000)
Capex		(21,483)	(20,380)	(37,500)	(28,500)
Acquisitions/disposals		0	0	0	0
Financing		23,581	19,958	0	0
Dividends		0	0	0	0
Other		0	0	0	0
Net Cash Flow		7,887	18,279	(8,375)	6,400
<b>Opening net debt/(cash)</b>		<b>(26,724)</b>	<b>(18,533)</b>	<b>(36,812)</b>	<b>(27,102)</b>
HP finance leases initiated		0	0	(1,335)	0
Other		0	0	0	0
<b>Closing net debt/(cash)</b>		<b>(34,611)</b>	<b>(36,812)</b>	<b>(27,102)</b>	<b>(33,502)</b>

Source: Company accounts, Edison Investment Research

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