Update

21 October 2010

Gulfsands Petroleum

Year End	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/08	53.6	(0.9)	0.9	0.0	537	N/A
12/09	84.4	33.7	28.3	0.0	17.1	N/A
12/10e	115.5	50.4	41.3	0.0	11.7	N/A
12/11e	138.4	73.1	60.0	0.0	8.1	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items. Assumes $1.5/£

Investment summary: Syria going strong

The recent analyst visit to Syria gave us an opportunity to get an update on Gulfands' key Syrian operations. Low cost production continues to provide strong cash flow, and, with management confirming better well performance than expected, a reserves review at the end of 2010 points to a potential reserves upgrade. A five well exploration programme over the next six months will provide opportunities for further upside potential.

Reserves upgrade likely

Strong well performance at existing fields gives evidence, backed up by management during the site visit, that reserves will be upgraded in the near future. Gulfsands expects to announce a reserves update in Q111. The results of recent delineation wells should also provide some increase, with current well KHE-18 results due imminently. We will update our valuation following publication of the update.

Drilling to accelerate

The arrival of a second rig in Syria for Gulfsands will accelerate the drilling of the remaining exploration prospects in its acreage and maximise the number of prospects that can be drilled by the licence deadline of August 2012. A programme of five wells over the next six months will provide several opportunities for further upside potential.

Valuation: Exploration to add value

The shares have responded well since the company announced interim results in September and, at 322p, are now approaching our RENAV of 330p. The market now fully recognises the value of the Syrian assets; however, success in the upcoming extensive drilling campaign would unlock further value.

Price	322p
Market Cap	£392m

Share price graph

Share details

Code	GPX
Listing	AIM
Sector	Oil & Gas
Shares in issue	121.6m

Price

52 week	High	Low
	331p	222p

Balance Sheet as at 30 June 2010

Debt/Equity (%)	N/A
Core NAV per share (p)	290
RENAV per share (p)	330
Net cash ($m)	68.6

Business

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

Valuation

	2009	2010e	2011e
P/E relative	156%	107%	86%
P/CF	12.5	7.2	5.7
EV/Sales	5.5	3.9	3.0
ROE	24%	27%	28%

Revenues by geography

UK	Europe	US	Other
0%	0%	10%	90%

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Gulfsands Petroleum is a research client of Edison Investment Research Limited

Syria at the core of asset base

Gulfsands Petroleum is an oil & gas exploration and production company with interests in Syria, Tunisia, the US and Iraq. In this update, we focus on the heart of the company's asset base, Syria, where it holds a 50% interest in Block 26 in the north-east corner of Syria. The block covers an area of 5,414km^2, and Gulfsands is the operator with Sinochem holding the remaining 50%.
The company has made two commercial discoveries in the last three years: Khurbet East, producing at 18,000bopd gross, and Yousefieh, producing at 3,000bopd. In addition, Gulfsands is planning to drill five exploration wells in the next six months as part of its drive to ensure that all remaining exploration potential in the block is drilled before the exploration licence expires in August 2012. The first well to be drilled by the new rig will be Zahraa-1, which we expect to be spudded imminently, as when we visited the well location the rig was in the process of being assembled onsite.

- Pressure response points to reserves upgrade. Analysis of pressure data from Khurbet East over the last two years shows that the reservoir pressure has only dropped by 12psi after around 9mmbbls of production, indicating that there is strong aquifer support in the field. As a result of this, Gulfsands expects to be able to increase the field recovery factor from its present 35%. In Yousefieh, similar pressure analysis shows a steeper decline than seen in Khurbet East that is more typical of Syrian fields. However, Gulfsands believes there is still some aquifer support in the field and also expects to increase the recovery factor here from the current 17%. The recovery factors and reserves will be reviewed by the end of 2010, with a reserves update expected in Q111.
- Proper reservoir management will maximise recovery. As further wells are drilled in Khurbet East, offtake will be reduced from existing wells in order to properly manage the reservoir over its 35-year production licence. New production wells will be drilled horizontally on the crest of the reservoir to delay water production. The pressure drop required to produce oil from horizontal wells is lower than that required from vertical wells, and this will also contribute to delaying water production.
- Five well exploration programme targeting further upside potential. Gulfsands has brought in a second rig to ensure that all exploration potential in Block 26 is drilled before the exploration licence expires in August 2012. Going forward, the prospects to be drilled are:
  1) Zahraa-1 – mean resources of 30mmbbl
  2) Twaiba – mean resource of 5mmbo, north of Khurbet East
  3) Abu Ghazal – the largest undrilled structure identified in Block 26 with mean resource of 18mmbbl
  4) Maghlouja updip – high risk- high reward well with mean resource of 156mmbbl
  5) Khurbet East Deep – primary target of gas in the Butma formation with P50 of 44bcf

Exhibit 1: Financials

$'000s	2007	2008	2009	2010e	2011e
Year end 31 December					
PROFIT & LOSS					
Revenue	37,309	53,600	84,415	115,471	138,445
Cost of Sales	(15,883)	(17,567)	(19,250)	(23,869)	(22,782)
Gross Profit	21,426	36,033	65,165	91,603	115,663
EBITDA	11,484	7,864	47,270	69,603	94,663
Operating Profit (before GW and except.)	11,484	(487)	34,489	50,077	71,545
Exceptionals	(720)	(6,384)	(5,882)	4,000	0
Operating Profit	10,764	(6,871)	28,607	54,077	71,545
Other	(1,475)	(1,667)	(1,056)	(1,084)	(1,084)
Net Interest	1,190	1,229	293	1,436	2,625
Profit Before Tax (norm)	11,199	(925)	33,726	50,429	73,087
Profit Before Tax (FRS 3)	10,479	(7,309)	27,844	54,429	73,087
Tax	2,557	1,932	(12)	(500)	(500)
Profit After Tax (norm)	13,756	1,007	33,714	49,929	72,587
Profit After Tax (FRS3)	13,036	(5,377)	27,832	53,929	72,587
Average Number of Shares Outstanding (m)	107.2	115.6	119.3	121.0	121.0
EPS - normalised (c)	12.8	0.9	28.3	41.3	60.0
EPS - FRS 3 (c)	12.2	(4.7)	23.3	44.6	60.0
Gross Margin (%)	57.4%	67.2%	77.2%	79.3%	83.5%
EBITDA Margin (%)	30.8%	14.7%	56.0%	60.3%	68.4%
Operating Margin (before GW and except.) (%)	30.8%	(0.9%)	40.9%	43.4%	51.7%
BALANCE SHEET					
Fixed Assets	94,203	90,565	101,650	141,925	166,206
Intangible Assets	28,593	343	7,091	13,091	18,091
Tangible Assets	49,532	77,055	82,569	116,844	136,125
Investment in associates	0	0	0	0	0
Long-term financial assets	16,078	13,167	11,990	11,990	11,990
Current Assets	29,687	54,749	83,655	114,989	155,773
Stocks	0	2,401	4,165	10,111	8,058
Debtors	11,154	15,536	21,867	32,332	34,611
Cash	18,533	36,812	57,623	72,546	113,104
Other	0	0	0	0	0
Current Liabilities	(23,496)	(17,122)	(17,094)	(52,726)	(43,681)
Creditors	(6,672)	(11,245)	(13,411)	(30,690)	(26,070)
Tax and social security	(16,824)	(5,877)	(3,683)	(22,036)	(17,611)
Short term borrowings	0	0	0	0	0
Provision for decommissioning	0	0	0	0	0
Long Term Liabilities	(18,756)	(20,430)	(27,937)	(22,036)	(17,611)
Deferred Tax Liabilitities	(1,932)	0	0	0	0
Provision for decommissioning	(16,824)	(20,430)	(27,937)	(22,036)	(17,611)
Net Assets	81,638	107,762	140,274	182,151	260,688
CASH FLOW					
Operating Cash Flow	5,055	16,908	41,539	73,470	92,817
Net Interest	1,190	1,229	293	1,436	2,625
Tax	(356)	(524)	(66)	(500)	(500)
Capex	(24,764)	(19,292)	(24,966)	(59,483)	(54,384)
Acquisitions/disposals	0	0	455	0	0
Financing	23,581	19,958	3,556	0	0
Dividends	0	0	0	0	0
Other	0	0	0	0	0
Net Cash Flow	4,706	18,279	20,811	14,923	40,558
Opening net debt/(cash)	(13,827)	(18,533)	(36,812)	(57,623)	(72,546)
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	0	0
Closing net debt/(cash)	(18,533)	(36,812)	(57,623)	(72,546)	(113,104)

Source: Edison Investment Research, Gulfsands Petroleum accounts