



11 June 2010

52-wk Range: £0.61-2.24
12 month target £1.00

Market Cap (M): £322.4
EV (M): £252.4

Oil & Gas

Gas in Sangaw North?

Summary

Sterling Energy is a UK-listed independent Oil & Gas company with assets in Northern Iraq, Cameroon and Madagascar.



Key Metrics

Shares Outstanding (M): 219.3
Current Price (GBP): £1.47

Event

Sterling Energy Plc announced that the Sangaw North #1 exploration well in the Sangaw North PSC, Kurdistan has now reached 1,505m is currently being drilled through the Shiranish horizon, the uppermost of the prospective Cretaceous aged formations in the Sangaw North prospect. While drilling this section gas shows and drill cuttings with fluorescence have been observed, both are indications of hydrocarbons being present in the well bore. The well plan is to drill through the Shiranish and then continue drilling to evaluate the prospectivity of the Kometan and Qamchuqa horizons in the Cretaceous and the deeper potential reservoirs in the Jurassic. Since the last update on 7 May 2010 two intermediate casing strings have been run; the 13 5/8" casing was run and cemented with the casing shoe at 1,053m TVD and the 9 7/8" casing was run and cemented with the casing shoe at 1,448m TVD.

Comment

While the presence of hydrocarbon is good news and not totally unexpected in the region, it seems most likely that Sangaw North will be a gas and condensates discovery. Nearby existing gas and condensates fields of Chemchemal and Khor Mor have reserves of 2.1Tcf and 1.8Tcf respectively. The discovery of gas was one of the risks in the Sangaw North prospect as gas has little commercial value in the near term. It is true that eventually an export route to Europe might materialise through the planned Nabucco pipeline and that at some point in time gas could be sold domestically in the way Khor Mor is being developed.

Assuming 3Tcf recoverable with a 100bbl/MMscf condensates ratio, we estimate the value of the 300MMb of condensates at 36p per share, risked at 67%. We also estimate that the gas itself could have a value of some 32p per share at some point, using a similar risk level but a lower NPV per barrel than for condensates.

In our initiation report of February 2010, we had also valued the assets in Cameroon at 32p despite the force majeure in place for the past 5 years.

With little else in the portfolio, given Madagascar standstill situation, we struggle to find much value beyond 100p and are therefore setting our revised target price at this level, down from 150p.

Recommendation

We acknowledge the excellent value creation track record of the present management team. We also believe that with proper finances now in place the restructuring of the portfolio will continue and new opportunities will materialise. However we view the discovery of gas as a bit of a setback.

The stock had a good bounce on the news yesterday and given the downside potential we downgrade it to a Sell rating.

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Lionel Therond

Lionel has worked at Fox-Davies since April 2009. Prior to this, he had 13 years experience as an investor at JPMorgan Asset Management and had previously spent 10 years in the Oil&Gas industry at Shell. Lionel graduated in Geology and Geophysics (MSc) before gaining an MBA at Insead; he is also a CFA charterholder.

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Research disclosure as of 11 June 2010

Company Name	Disclosure
Sterling Energy (SEY)	7

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Company	Ticker	Recommendation	Date	Target Price	Last Price
Oil & Gas					
Ascent Resources	AST LN Equity	BUY	22.04.10	£0.20	£0.03
Borders & Southern Petroleum	BOR LN Equity	BUY	01.02.10	£1.50	£0.68
Circle Oil	COP LN Equity	BUY	27.05.10	£0.90	£0.35
Desire Petroleum	DES LN Equity	HOLD	29.03.10	£1.00	£0.87
Enegi Oil	ENEG LN Equity	SELL	17.05.10	£0.10	£0.24
Falklands Oil & Gas	FOGL LN Equity	BUY	01.02.10	£4.00	£2.01
Gulf Keystone	GKP LN Equity	BUY	25.05.10	£2.00	£0.72
Gulfsands Petroleum	GPX LN Equity	HOLD	04.05.10	£3.00	£2.71
Hardy Oil & Gas	HDY LN Equity	BUY	26.05.10	£3.00	£1.58
Matra Petroleum	MTA LN Equity	BUY	26.05.10	£0.07	£0.02
Max Petroleum	MXP LN Equity	BUY	02.06.10	£0.50	£0.14
Petrokamchatka	PKP CN Equity	HOLD	14.01.10	C\$0.15	C\$0.045
Po Valley	PVE AU Equity	BUY	29.04.10	A\$1.50	A\$0.375
Range Resources	RRL LN Equity	BUY	17.12.09	£0.08	£0.05
Rockhopper Exploration	RKH LN Equity	BUY	04.06.10	£4.00	£2.85
San Leon Energy	SLE LN Equity	BUY	02.06.10	£0.80	£0.18
Sterling Energy	SEY LN Equity	SELL	11.06.10	£1.00	£1.49
Tower Resources	TRP LN Equity	HOLD	23.03.10	£0.02	£0.02
Victoria Oil & Gas	VOG LN Equity	BUY	21.04.10	£0.09	£0.03

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