

Europa Oil & Gas

CORPORATE*

Production and appraisal upside

13p[#]

Year-end July	2008A	2009A	2010E	2011E
Turnover (£m)	4.4	2.9	3.2	6.0
EBITDA (£m)	3.1	1.0	1.0	4.0
Adj. Pre-tax Profit (£m)	2.1	0.7	1.1	3.0
Adj. EPS (p)	0.7	0.6	0.7	1.8
DPS (p)	0.0	0.0	0.0	0.0
Net Cash/(Debt) (£m)	(1.9)	(1.5)	(1.3)	(1.4)
P/E (x)	18.3	22.4	18.1	7.2
Dividend yield (%)	n/a	n/a	n/a	n/a
EV/EBITDA (x)	3.9	12.0	12.0	3.0

Key Data	
Ticker	EOG.L
Shares in issue	82.2m
Market cap	£10.7m
12-mth price range	6.8-27.0p
Net debt (2010E)	£1.3m
Next events	Voitinel-1 testing ("1400" zone) UK production enhancement

Source: Company, Astaire Securities estimates

[#]Priced at close, 27 May 2010

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Europa is targeting net production of 500bopd by the calendar year end, and we are forecasting 88% revenue growth in FY2011. We like the diversity of the portfolio and the company's onshore European focus, seeing the Voitinel gas discovery in Romania as a critical value driver and short term catalyst. Ahead of further test results at Voitinel, we calculate Risked NAV of 40p/share, with good scope for upgrades as appraisal work continues.

- * **Risked NAV of 40p/share:** compared to our Risked NAV estimate, the shares look undervalued at the current stage, even if existing 2P reserves are quite modest. A priority is to book additional Contingent Resources, particularly at Voitinel where further test results are expected next month.
- * **Diverse European portfolio:** Europa has a diverse portfolio of projects sitting across the E&P value chain, including production, appraisal and exploration. Although we believe that Voitinel is particularly important, Europa's spread of assets mitigates risk, as does its focus on politically stable countries.
- * **Rising production and profits:** although small, Europa is an established producer (and operator), with net production averaging 215bopd onshore UK. The onshore focus minimises costs and Europa is already profitable; we are forecasting FY2011 EPS of 1.8p as production ramps up at existing fields.
- * **Share price catalysts:** following good initial results from Voitinel-1, more news is expected across the portfolio in coming months. Europa aims to enhance UK production, and will undertake further drilling in Romania following the completion of Voitinel-1 testing. The recent £1m placing removes near term funding risks.

Company description

Europa Oil & Gas has production, appraisal and exploration assets in three core European countries: the UK, Romania and France. The company has completed stimulation of one zone in the successful Voitinel-1 well in Romania, and is targeting UK production of 500bopd by late 2010.

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Introduction

Europa Oil & Gas is a European-focused E&P company with assets in the UK, Romania and France. The company is producing around 200bopd (net) from three oilfields onshore UK, and aims to get this up to 500bopd by late 2010. Increasing production from existing projects forms part of a two-pronged strategy; expanding the contingent resource base is the company's second key objective.

Of Europa's three producing fields in the East Midlands, two are operated (Crosby Warren, West Firsby) and one is non-operated (Whisby). In the first half of the current financial year, these produced at an average daily rate of 172bopd net. However, production had been affected by a fire at West Firsby in 2009 and, with much of this facility now back on stream, it currently averages 215bopd.

Whisby is expected to continue in shallow decline, so Crosby Warren and West Firsby will be the focus of plans to enhance production with a programme of reservoir stimulation, production optimisation and drilling. A fourth field, Hykeham, is located 2km from Whisby, although the discovery well has so far failed to flow at commercial rates on test. Our production forecasts seem conservative compared to Europa's 500bopd target, but still imply a material uplift in FY2011.

Europa also has a portfolio of exploration and appraisal-stage projects. Of these, the Voitinel gas discovery in Romania (operator: Aurelian) seems particularly exciting following the recent success of the Voitinel-1 well. One interval has been fraced and tested at a stabilised rate of 2.5mmcf/d ahead of testing of a second zone. The wider Voitinel play is estimated to contain up to 15mmboe recoverable (net), offering considerable appraisal upside.

Europa is already generating revenues and we are forecasting sales of £6.0m next year. With field OPEX of less than US\$25/bbl, we estimate that this will translate into net profits of £1.5m. The recent £1m placing strengthens the balance sheet and, taking into account rising production and reserve upside potential, we think that the stock provides excellent value, trading at an approximate 70% discount to our 40p/share Risked NAV estimate.

Europa is targeting production growth and expansion of its Contingent Resource base

Production ramping up from existing UK fields

Voitinel gas discovery is an important value driver

Europa is profitable and trades at a circa 70% discount to our 40p/share Risked NAV estimate

Reserves and resources

Reserves	1P	2P	3P
Oil mmbbl	0.6	0.7	1.2
Gas bcf	-	-	-
Total mmboe	0.6	0.7	1.2
Contingent Resources	P90	P50	P10
Oil mmbbl	1.1	2.1	3.0
Gas bcf	7	11	131
Total mmboe	2	4	25
Prospective Resources	P90	P50	P10
Oil mmbbl	10	16	28
Gas bcf	-	-	-
Total mmboe	10	16	28

Source: Europa

Valuation

We have taken a 'risked in ground' valuation approach, using an implied reserve value of US\$12.50/boe in the UK, US\$10.00 in France, US\$7.50 in Romania, and resource estimates provided by the company. We have then risked reserves and resources according to category. Volumetric estimates are a combination of numbers verified by Energy Resource Consultants in late 2008, adjusted for subsequent production, and in-house estimates. We have risked Contingent Resources at 30%, with the exception of the Voitinel core area which is risked at 50% following recent test results; Prospective Resources are risked at 10%.

We have taken a 'risked in ground' valuation approach

Adjusting for the present value of central costs and for net debt, this results in Risked NAV of 40p/share. Of this, 14p comes from Voitinel which implicitly underpins the share price in spite of our aggressive risk assumptions. We have assumed 15mboe of net reserve potential in the wider Voitinel play, which we think is reasonable even if this figure has yet to be formally classified as a Prospective Resource. We have also included Berenx, assuming that Europa successfully farms out to retain a 25% interest and reflecting only the smallest of four reservoir targets (70bcf net).

Voitinel accounts for one third of estimated Risked NAV

Although Europa's 2P reserve base is relatively small, and much of our valuation consists of 'risked upside', the shares look very undervalued at the current stage. A priority is to book the Contingent Resources that are likely to exist at Berenx and Voitinel. We think that Voitinel (which already has 11bcf in the Contingent Resource category) is very important, with recent test results from Voitinel-1 providing lots of encouragement. Further progress could add significant value to the portfolio, and provide share price catalysts in the short term.

Priority is to book additional Contingent Resources

Sum-of-the-parts valuation

	Unrisked US\$m	PoS %	Risked US\$m	Unrisked US\$/ share	Risked US\$/ share	Risked GBP/ share
West Firsby	5.0	100	5.0	0.06	0.06	0.04
Crosby Warren	2.5	100	2.5	0.03	0.03	0.02
Whisby	1.3	100	1.3	0.02	0.02	0.01
Hykeham	8.8	30	2.6	0.11	0.03	0.02
Osmets	15.0	30	4.5	0.18	0.05	0.03
Boistea	0.3	30	0.1	0.00	0.00	0.00
Voitinel base	14.2	50	7.1	0.17	0.09	0.05
Voitinel upside	112.5	10	11.3	1.37	0.14	0.09
Berenx	30.2	30	9.1	0.37	0.11	0.07
Wressle	47.5	10	4.8	0.58	0.06	0.04
Holmwood	112.5	10	11.3	1.37	0.14	0.09
Barchiz	24.0	10	2.4	0.29	0.03	0.02
Net debt	(2.1)	100	(2.1)	(0.03)	(0.03)	(0.02)
G&A	(7.4)	100	(7.4)	(0.09)	(0.09)	(0.06)
Total NAV	364.3	-	52.3	4.43	0.64	0.40

Source: Astaire Securities

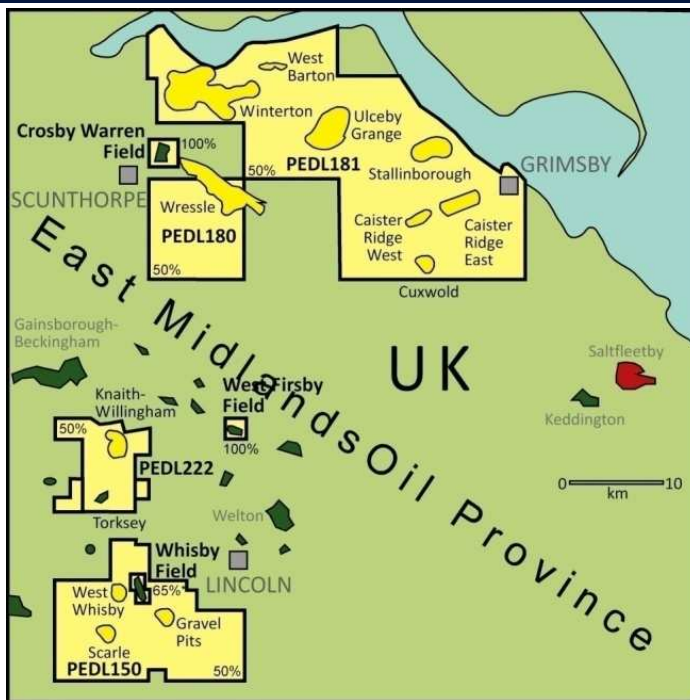
Project descriptions

United Kingdom

Europa is producing from three oilfields in the East Midlands: West Firsby, Whisby and Crosby Warren. These produced an average of 172bopd (net) in the first half of the current financial year, down from the 228bopd achieved in the first half of FY2009 as a result of last June's fire at West Firsby. However, with much of this facility now back on stream, daily production has recovered to reach 215bopd. Oil from the three fields is trucked to ConocoPhillips' refinery at Immingham.

Currently producing 215bopd from three UK fields

Location map – United Kingdom



Source: Europa

Over the coming months, an important priority for Europa is to enhance production from its UK fields. Whisby, which is operated by Blackland Park, is expected to continue in shallow decline, so Europa will focus its attentions on Crosby Warren and West Firsby, both of which are operated by the company. The first step is to upgrade surface facilities (including pumps) at West Firsby. This is scheduled to take place in coming weeks, and will be followed by a workover of Crosby Warren-2 in September, which has been shut in since 2008. Combined, this work is expected to add 115bopd, taking total daily production to 330bopd.

Production enhancement programme planned

Beyond this, a further production well is planned at West Firsby (WF-9), with drilling scheduled for October (subject to Europa having sufficient funds) and the potential to add a further 100-200bopd. Despite the Hykeham-1 test results, Europa has maintained its target production rate for the end of this year at 500bopd (net). We think that 450bopd is readily achievable, with scope to surprise on the upside, and assume average daily production of 350bopd in our FY2011 forecasts.

Targeting 500bopd by late 2010

The Hykeham appraisal project (operator: Europa) is located around 2km from Whisby. Europa drilled the Hykeham-1 exploration well in November 2009, with logs confirming a 4m oil-bearing reservoir. Hykeham-1 was subsequently completed as a producer and perforated ahead of long term production testing. However, the well produced only small volumes on test, and was recently shut in ahead of a decision on what remedial action to take. The Hykeham-1 test results conflict with the available geological data and indicate formation damage; the well has now been re-completed and Europa hopes to achieve modest rates of production following installation of a new pump over the next couple of weeks.

Europa hopes to get Hykeham-1 producing at modest rates

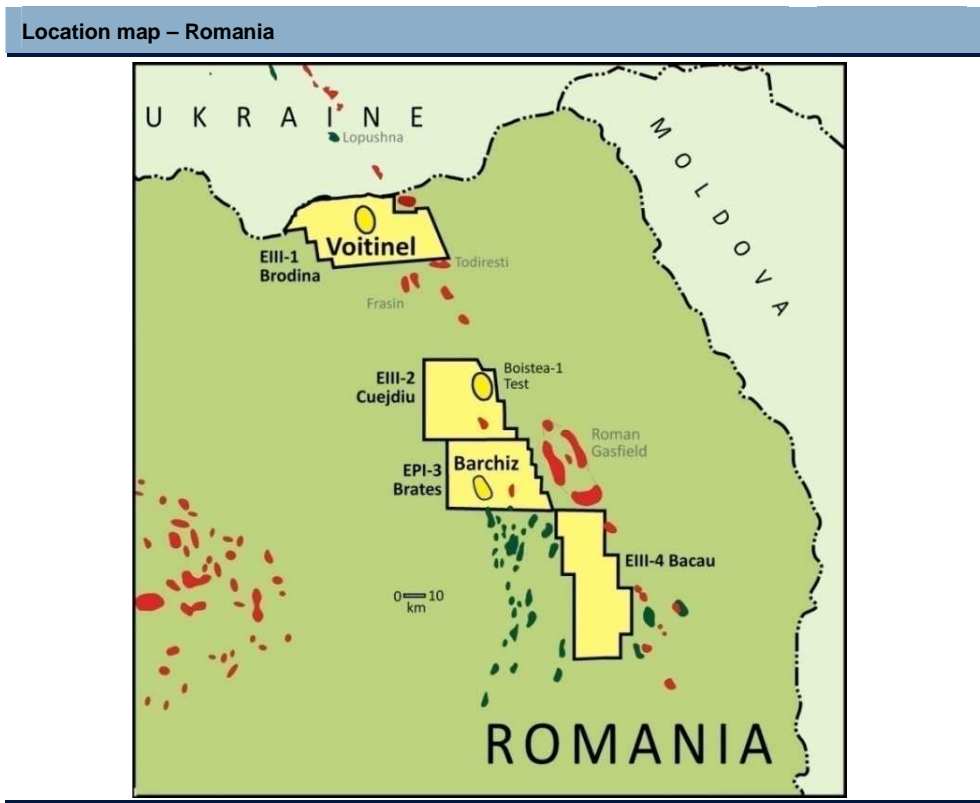
Europa's UK portfolio also includes operated exploration licences covering four main areas in the East Midlands and Weald Basin, providing 13mmbbl (net) of reserve upside potential in projects close to the company's existing production, in addition to unconventional shale gas opportunities. The Wressle prospect is close to Crosby Warren and likely to be drilled in 2011. Caistor Horst is located between Crosby Warren and the 90bcf Saltfleetby gasfield; 3D seismic data has recently been reprocessed ahead of selection of a 2011 drilling location. Holmwood is already well defined, with drilling also possible in 2011 subject to planning consents. Finally, West Whisby neighbours the Whisby field and contains a large, secondary gas target.

Exploration upside in proximity to existing production

Romania

Europa has 28.75% of the Voitinel gas project, which forms part of the prolific Carpathian gas play in northern Romania. The operator, Aurelian Oil & Gas, drilled the Voitinel-1 exploration well in late 2009. This was originally targeting oil but encountered gas-bearing sands at 1650m. These flowed dry gas at 3mmcf/d on initial test, while a second gas-bearing zone was identified on the logs at 1400m, but not tested at the time.

Voitinel-1 discovery well encountered two gas-bearing zones



Source: Europa

The partners recently commenced fracking of the “1650” sand interval ahead of a short flow test and testing of the second zone. An update was released on Monday 24 May, coming in line with the anticipated timetable and confirming the completion of fracking and testing of the “1650” sand. Europa reported that Voitinel-1 flowed at a stabilised rate of 2.5mmcf/d, representing a 67% improvement on the stabilised flow rate achieved in October 2009. Importantly, the partners now conclude that each development well has the potential to produce up to 6bcf at an average daily rate of 2.5mmcf/d in the first year; the next step is to recomplete and test the “1400” sand with results due next month.

“1650” sand successfully fraced and tested; results from second zone due next month

The operator currently estimates 400bcf of gas-in-place in the wider Voitinel play, with up to 100bcf in the core area tested. Ahead of test results from the “1400” zone, Monday’s update was highly encouraging, providing confidence in the effectiveness of fracking in increasing gas recoveries, and derisking the core Voitinel area. Results from testing are expected to assist with development well planning, and provide a more accurate estimate of reserve potential; Europa plans to commission an independent report to quantify the impact on resources.

Independent reserves report to be commissioned

Importantly, the Romanian state gas company Romgaz drilled two wells (Paltinu-102 and 103) south of Voitinel last year. These were successful and indicate better reservoir quality (i.e. flow rates) to the south. Once all the test results from Voitinel-1 have been received and interpreted, the partners hope to make a decision in June or July on the location of a follow-up appraisal well (Voitinel-2). This could be a low risk step-out well designed to prove up a modest reserve base in the core Voitinel area, or target greater upside by drilling further south of the existing discovery well. Voitinel-2 is likely to be drilled late this calendar year or early in 2011.

Location of Voitinel-2 appraisal well to be confirmed shortly

Voitinel forms part of the Brodina project which also has the potential for oil in a thrustbelt play to the west. Other earlier stage exploration projects in Romania include Cujeidiu (Europa 17.5%, operator Aurelian) where a seismic survey is planned for late 2010 or early 2011. Europa is also partnered with Aurelian at Bacau where it has a 19% non-operated interest; following a disappointing result from the Lileci well (which Europa opted out of), future exploration work will now focus on the western part of this licence.

Finally, at Brates (Europa 20%, operator MND), a shallow well is scheduled for drilling in the second half of this year to test the Barchiz prospect, which is 10km along trend from the 50mmbbl Geamana oilfield. We think that this prospect is an important part of the Romanian portfolio because of its drill-ready status; we also like the fact that it introduces an oil component into a portfolio that is otherwise quite gas-weighted in Romania and France. Europa’s Romanian interests are entirely non-operated but in the hands of capable independents (primarily Aurelian which is also listed on AIM).

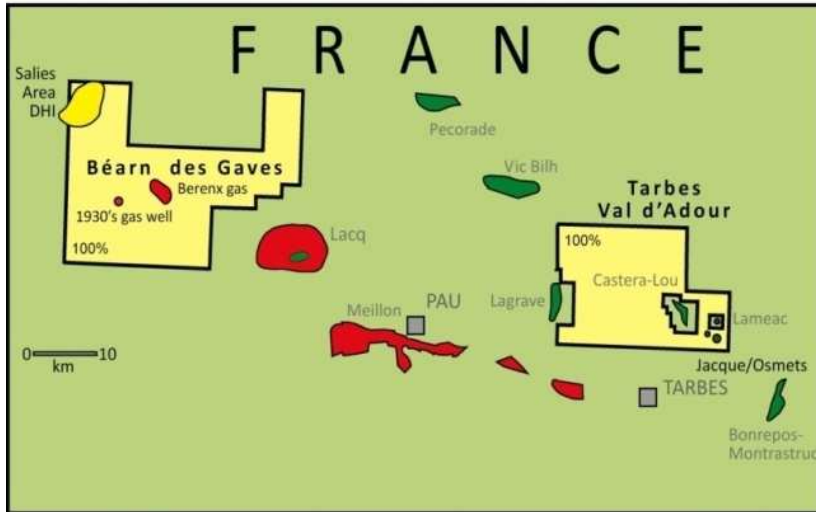
Barchiz-1 exploration well scheduled for later this year

France

In addition to the UK and Romania, France forms the final leg of Europa's portfolio. Activities are focused on the Aquitaine basin where Europa has a 100% interest in the Bearn des Gaves and Tarbes val d'Adour licences.

Europa has 100% of two projects in the Aquitaine basin

Location map – France



Source: Europa

Bearn des Gaves contains the Berenx gas discovery where two wells drilled in 1969/75 encountered significant gas-bearing intervals at similar stratigraphic levels to the nearby Lacq gasfield. Lacq is operated by Total and, as France's largest gasfield (8.7tcf), provides an important analogy to Berenx which lies 20km to the west. Berenx is a deep high pressure, high temperature gas play providing multi-TCF potential, with up to 1.7tcf of estimated gas-in-place. The historic Berenx-1 and 2 wells encountered a 500m gas-bearing zone at depths of up to 6200m, but were not tested at the time due to the high gas pressures. Europa believes that modern drilling technologies now make Berenx a viable (and exciting) candidate for appraisal and development.

Berenx is an existing deep gas discovery in proximity to Total's Lacq gasfield

Europa has just received a package of reprocessed 3-D seismic data from Total (acquired in 2005); this will be integrated with subsurface mapping data ahead of seeking farm-in support from companies with deep drilling expertise, with marketing expected to commence in July. It is worth noting that Total, as operator of Lacq (which has surplus processing capacity), stands out as a potential farm-in candidate. Although the prize is large, so are the costs, which are estimated at €30m for a 2011 appraisal well. This necessitates farm-in support, although Europa expects to retain a meaningful exposure to this large project going forward.

Data integration underway ahead of farm-out negotiations

The company hopes to have agreed farm-in terms with a relevant partner by September, ahead of the commencement of appraisal drilling. Berenx looks like a particularly exciting project as the reserve upside is significant, the project already sits at the appraisal stage, and attraction of a high profile farm-in partner could act as an important catalyst for the shares in coming months.

Appraisal drilling could commence next year

In addition to Berenx, Europa's second Aquitaine licence at Tarbes val d'Adour contains three oil accumulations which have previously produced commercially, but were abandoned in 1985 in a period of very low oil prices. Osmets (Contingent Resources 1.5mmbbl) is the first candidate for redevelopment by horizontal drilling, although we do not assume any expenditure here during our forecast period. Beyond Berenx and Osmets, there is significant undrilled exploration potential in both licences which are located in an area of the Aquitaine basin which has seen little exploration since 1985, despite significant discovered reserves of 2 billion barrels of oil equivalent.

Osmets is a field redevelopment candidate

Other assets

For the sake of completeness, we note that Europa has a 2.5% overriding royalty interest in four blocks operated by RWE-Dea in Poland, including the Ropa/Pola development where the partners maintain a watching brief. Europa also has 100% of two licences in Western Sahara although these are currently in *force majeure* (due to Western Sahara's political dispute with Morocco) and therefore inactive. Our forecasts and valuation take no account of either the Polish or Western Saharan projects given their current status and the fact that they absorb little (if any) cash. Europa's concession at West Darag in Egypt was relinquished (and written off) in the first half of the current financial year.

Financial forecasts

We have generated P&L and cash flow forecasts for FY2010 and FY2011, when we assume average daily production of 200bopd and 350bopd, respectively. We have used a US\$70/bbl price deck for the current financial year, rising to US\$75/bbl in FY2011 when we expect revenues of £6m (up 88% year-on-year).

We expect FY2011 revenues to increase 88% year-on-year

Because of the fixed component within operating costs, we expect Europa to benefit from real economies of scale as production ramps up, and conservatively estimate cash costs of US\$20/bbl next year. Higher production and an improved netback per barrel translate into net profit of £1.5m and adjusted EPS of 1.8p (compared to 0.7p in FY2010).

Higher production gives operational gearing and EPS of 1.8p next year

From a cash flow perspective, we expect capex of approximately £4m both this year and next, although most of this will be covered by cash flow from production in FY2011. We therefore expect the net debt position to stabilise at under £1.5m, largely covered by a £1m overdraft facility with RBS. Europa also has a £0.6m term loan although this is repayable over the next 18 months, implying the need for some additional financing (equity or debt) in due course.

Net debt to stabilise; capital spend is largely discretionary

However, according to our projections, it is important to note that Voitinel-1 and 2 are the only non-discretionary items of planned expenditure, and Europa may be in a position to fund the entire work programme internally (and accelerate drilling of West Firsby-9) if production rates surprise on the upside.

Profit and loss

Year end July (£'000)	2008A	2009A	2010E	2011E
Revenues	4,418	2,936	3,194	5,988
Exploration write-offs	(1)	(297)	(738)	0
Operating costs	(1,548)	(1,694)	(1,620)	(2,595)
Gross profit	2,869	945	836	3,393
Admin expenses	(376)	(498)	(460)	(400)
Operating profit	2,493	447	376	2,993
Net interest	(439)	(24)	(25)	(25)
Profit before tax	2,054	423	351	2,968
Adjusted PBT	2,055	720	1,089	2,968
Tax	(1,609)	(356)	(545)	(1,484)
Net profit	445	67	(193)	1,484
Discontinued operations	(296)	(47)	0	0
Profit for the year	149	20	(193)	1,484
<i>Average shares (000)</i>	<i>63,181</i>	<i>62,564</i>	<i>75,500</i>	<i>82,207</i>
<i>EPS (p)</i>	<i>0.24</i>	<i>0.03</i>	<i>(0.26)</i>	<i>1.81</i>
<i>Adjusted EPS (p)</i>	<i>0.71</i>	<i>0.58</i>	<i>0.72</i>	<i>1.81</i>

Source: Company, Astaire Securities estimates

Cash flow

Year end July (£'000)	2008A	2009A	2010E	2011E
Profit for the year	149	20	(193)	1,484
Share based payments	(3)	96	70	0
Depreciation	590	576	570	998
Exploration write-off	297	297	738	0
Loss on disposal	2	0	0	0
Net interest	307	(114)	0	0
Tax	1,287	176	400	1,484
Change in working capital	181	222	0	0
Operating cash flow	2,810	1,273	1,585	3,966
Capital expenditure	(1,438)	(191)	(500)	(1,000)
Exploration expenditure	(3,655)	(930)	(3,500)	(3,100)
Disposals	1,023	0	0	0
Free cash flow	(1,260)	152	(2,415)	(134)
Share issues (net)	95	0	2,643	0
Net cash flow	(1,165)	152	228	(134)
FX differences	(47)	160	0	0
<i>Opening net cash/(debt)</i>	<i>(635)</i>	<i>(1,847)</i>	<i>(1,535)</i>	<i>(1,307)</i>
<i>Closing net cash/(debt)</i>	<i>(1,847)</i>	<i>(1,535)</i>	<i>(1,307)</i>	<i>(1,441)</i>

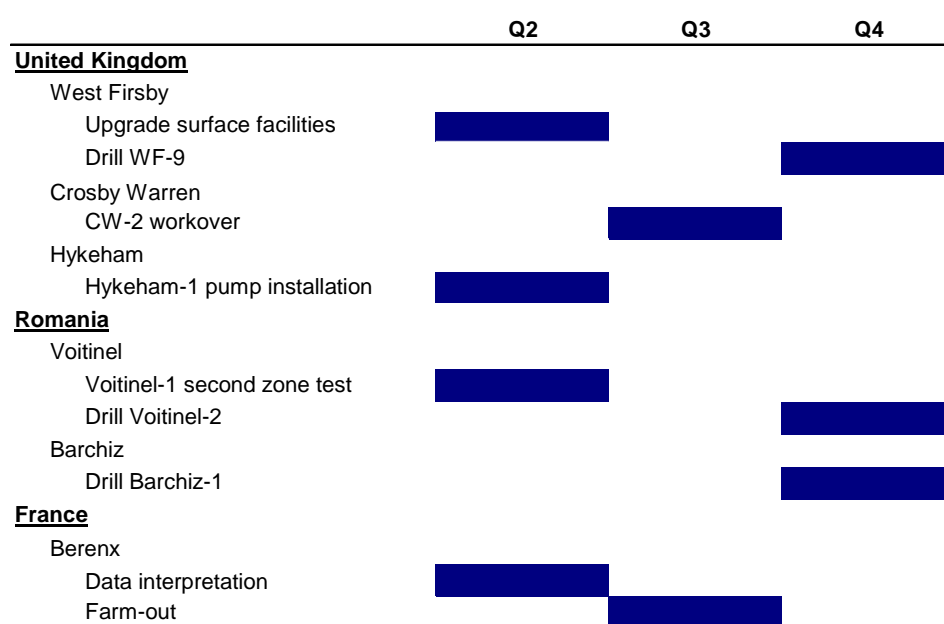
Source: Company, Astaire Securities estimates

Summary table – key projects

Asset	Country	Status	Operator	Europa interest	Gross production	Next Steps
Crosby Warren	UK	Production	Europa	100%	44bopd	Crosby Warren-2 workover
West Firsby	UK	Production	Europa	100%	90bopd	Surface facilities upgrade; drill WF-9
Whisby	UK	Production	Blackland Park	65%	102bopd	No immediate plans
Hykeham	UK	Appraisal	Europa	75%	None	Installation of new pump at Hykeham-1
Voitinel	Romania	Appraisal	Aurelian	28.75%	None	Testing of "1400" zone in Voitinel-1
Barchiz	Romania	Exploration	MND	20%	None	Drilling of Barchiz-1 well
Berenx	France	Appraisal	Europa	100%	None	Data integration; farm-out
Osmets	France	Development	Europa	100%	None	Field redevelopment in due course

Source: Europa, Astaire Securities

2010 project timeline

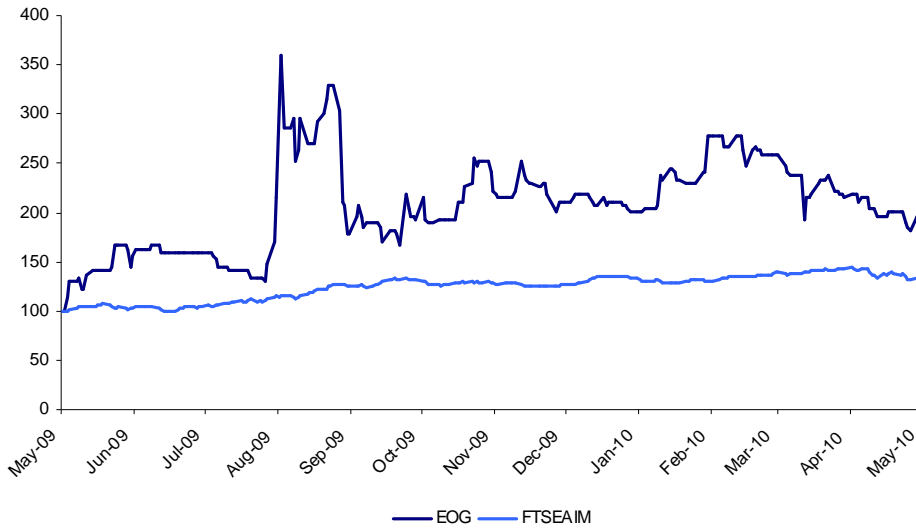


Source: Europa, Astaire Securities

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Share Price Performance – EOG.L vs UK FTSE AIM All-Share (rebased)



Source: Datastream





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