

Summary Data

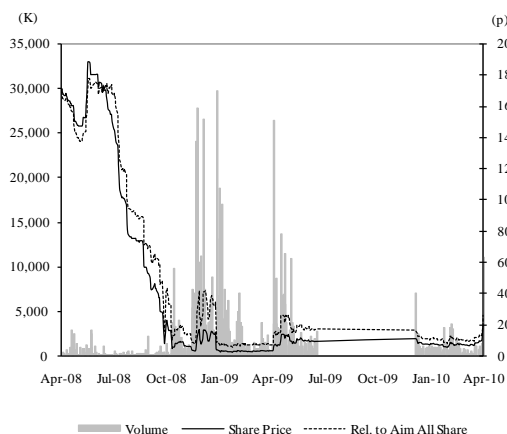
Price (p)	18.50
Market Cap (£m)	33.23
Shares in issue (000)	179,649
Sector	Oil and Gas

Source: Fidessa, Allenby Capital

Urals Energy PCL (UEN.L)

Petraco: Reduced uncertainty lifts valuation

Share price performance



Source: Fidessa, Allenby Capital

Urals has made two significant announcements over the last week. The announcement on April 12 concerning the Petraco debt restructuring agreement removed a major area of uncertainty surrounding the company. The agreement calls for \$2m of debt to be converted to equity which is subject to a lock-in and a potential \$5m equity injection by Petraco via an exercise of options. The latter is sufficient to finance the bulk of the first two debt repayments totalling \$6m in September and December 2010. We believe the remaining repayment schedule through December 2013 can be financed from cash flow, particularly given tuesday's positive operational update which gives us confidence in our production assumptions. Since our initiation of 31 March the stock has soared by 174% nearing a 12-month high but remains below our new conservatively assessed estimate of fair value of 35p/share. Urals also sells at a decidedly modest \$0.9/barrel of estimated recoverable reserves of 59mm barrels.

Key data (Y/E 31 December)

(\$k)	2008A	2009E	2010E	2011E
Turnover	222,291	57,483	68,043	81,702
Growth		-74.1%	18.4%	20.1%
Gross Profit	24,647	9,673	19,870	24,170
EBITDA	(12,502)	(2,965)	14,870	19,170
EBIT	(29,016)	(7,098)	9,959	14,286
Net finance charge	(299,227)	(59,299)	(1,746)	(1,430)
PBT	(328,243)	(66,397)	8,213	12,856
Net profit	(290,866)	(36,397)	8,213	12,856
Number of shares	179,985	179,649	189,647	192,982
Net debt/(cash)	890,699	32,900	31,223	28,295
P/E	N/A	N/A	4.2	2.8
EV/EBITDA	N/A	N/A	5.5	4.0

Source: Urals Energy PCL, Edison Investment Research. Figures exclude one-offs.

Key shareholders

Finfund Limited	12.66%
V.V.Rovneiko	8.56%
L.Y.Dyachenko (Chairman)	3.81%
G.N.Ramzaitsev	3.71%
Nafta B	3.05%
Management	0.43%

Source: Urals Energy PCL

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The bulk of the debt relates to Petraco The debt owed to trading company Petraco amounts to \$34.3m and was originally incurred as part of a revolving pre-payment facility against future deliveries of oil. We believe this debt constitutes virtually all Urals indebtedness. Prior to the agreement the need to repay all the Petraco facility by the end of 2010 had at times threatened the very existence of Urals.

Urals fields will be used as collateral A key feature of the Petraco debt agreement is that Urals is required to pledge as collateral its two fields, Articneft and Petrosakh. Other important terms concerning the agreement include the stipulation that if a \$34m loan to Taas Yuriakh is repaid in 2010 the maximum payment by Urals to Petraco will be cut to \$10m. Interest on the outstanding balance owed will be levied un-compounded at 6 month LIBOR plus 5%. Currently this equates to about 5.5%. Post the agreement Petraco, assuming it exercises its options, could become one of the largest shareholder with a stake of about 12%.

Cash flow should be adequate to pay down debt We are currently looking for operating cash flow of about \$14m in 2010 and \$19m in 2011. We believe cash flow could be significantly above \$20m in 2012 if, as expected production can be boosted from about 2,200 b/d presently to perhaps 3,000 b/d. This scenario would be sufficient to comfortably finance the debt repayments post 2010 of \$8m in 2011, \$11.7m in 2012 and possibly about \$11m in 2013, including accrued interest. The scope for capital spending may however be constrained. To provide some extra leeway Urals has indicated it is considering a fund raise in the near future.

Modestly valued We are raising our price target from 23p/share to 35p/share as the Petraco agreement ensures the future viability of Urals. The lower risk is reflected in our WACC being reduced from 15% to 12.5%. Conceivably, a valuation closer to 50p/share is justifiable. Note, the valuation of \$0.9/barrel is significantly under the average for Russian E&P plays of about \$2/barrel.

Positive operational update

Urals Energy provided an operational update in this and last week's announcements. Whilst neither announcement contains dramatic news the information provided is broadly positive.

According to the update, production is currently running at c.2,300 b/d split c.1,600 b/d Petrosakh (Sakhalin Island Pacific coast) and 700 b/d Artineft (Kolguev Island Barents Sea). The production rate is therefore similar to 2009. A key item of news concerns the upcoming side track well 35b at Petrosakh. This is now expected to be spud in early June, 2010 with production commencing in July at a rate of 225 b/d. A second side-track is expected in July. Drilling costs are low by international standards and are not expected to exceed \$0.53m.

The high octane gasoline on Petrosakh has been certified to be a higher quality than State Norms, resulting in a higher net back and less seasonal volatility. Urals intends producing and marketing the higher quality Gasoline 92 by May 2010 which provides a further \$20.94/tn netback when compared to Gasoline 80. It also will allow for year round sales, removing seasonal volatility.

Workover activity has been undertaken of late at both Petrosakh and Artineft. This has succeeded in firming production trends particularly at the latter. In the western section of the Artineft field several minor workovers have resulted in an increase in production recently of 56 b/d. The planned restart in April of shut-in wells could add another 70 b/d at Artineft. All told, production in 2010 could exceed \$2,500 b/d.

Financials: Balance sheet strengthened

There are still some outstanding issues concerning the Petraco debt restructuring agreement that will have a major bearing on the financial outlook. The most important near term concerns whether or not Petraco exercises its options post the EGM scheduled for April 29, 2010. Although this seems likely, we have reassessed the financial outlook on the conservative assumptions that the options are not exercised and also that there is no early repayment of the loan made to Taas. On these assumptions we have raised our pre-tax forecasts for 2010 and 2011 from \$7.86m to \$8.21m and from \$11.84m to \$12.86m respectively. The variance reflects lower interest expense stemming from the restructuring agreement with Petraco.

Prospectively the balance sheet is now showing the semblance of solidity even on the above assumptions. At the end of 2010 net debt is forecast at \$31.2m which would imply a debt:equity ratio of 40% against 52% a year previously and 255% in 2008. Assuming that Petraco's options are exercised the debt:equity ratio at end 2010 would come in at about 31%.

Valuation: Raising price target to 35p/share

The strengthening balance sheet arguably has profound positive implications for valuation. In our recent base case assessment of fair value of 23p/share we had assumed a cost of capital of 15% reflecting the weak balance sheet. Arguably post the debt restructuring agreement 12.5% is more realistic and reflects a stronger balance sheet and the removal of a key uncertainty around Urals being able to repay the loan to Petraco by the end of 2010. This boosts the valuation to 35p/share. It should also be noted that the base case reflects a \$60/barrel light oil price and the assumption that only 50% of the loan to Tass will be repaid. If we were to assume \$80/barrel oil, a 12.5% cost of capital the valuation would exceed 50p/share.

Financial Forecasts

Exhibit 1: P&L and cash flow

Y/E December	\$k	\$k	\$k	\$k	
	FY 2008A	FY 2009E	FY 2010E	FY 2011E	Comments
Profit & Loss					
Turnover	222,291	57,483	68,043	81,702	COS includes:
<i>Growth</i>	N/A	-74.1%	18.4%	20.1%	Mineral Extraction Tax, Export Duties and Excise Tax, Lifting costs
Cost of Sales	(197,644)	(47,810)	(48,173)	(57,532)	
Gross Profit	24,647	9,673	19,870	24,170	
<i>Margin</i>	11.1%	16.8%	29.2%	29.6%	
Depreciation and Amortisation	(16,514)	(4,133)	(4,911)	(4,884)	
Selling, general and admin expenses	(44,331)	(12,638)	(5,000)	(5,000)	
One off non cash costs	(112,383)	(276,792)	-	-	
Total Admin expenses	(173,228)	(293,563)	(9,911)	(9,884)	
as a % of sales	-77.9%	-510.7%	-14.6%	-12.1%	
Other operating income	7,182	-	-	-	
EBIT excluding one off costs	(29,016)	(7,098)	9,959	14,286	
<i>Margin</i>	-13.1%	-12.3%	14.6%	17.5%	
Net finance expense	(299,227)	(59,299)	(1,746)	(1,430)	Assume repayment of interest to Petraco at libor+5%
Profit/(loss) before taxes excluding one off costs	(328,243)	(66,397)	8,213	12,856	
Profit/(loss) before taxes	(440,626)	(343,189)	8,213	12,856	
Tax	37,377.0	30,000.0	-	-	
Net Profit/Loss	(403,249)	(313,189)	8,213	12,856	
EPS					
Basic (c)	(225.74)	(174.33)	4.33	6.66	
Diluted (c)	(225.74)	(174.33)	4.33	6.66	
Shares					
Basic, wtd ave (m)	177.99	179.65	189.65	192.98	
Diluted, wtd ave (m)	177.99	179.65	189.65	192.98	
EBITDA excluding one-off costs	(12,502)	(2,965)	14,870	19,170	
Cash Flow					
	FY 2008A	FY 2009E	FY 2010E	FY 2011E	
PBT	(440,626)	(343,189)	8,213	12,856	
D&A	16,514	4,133	4,911	4,884	
Share based payments	8,971	1,823	-	-	
Profit on sale of plant and equipment	(8,121)	-	-	-	
Non cash transactions	418,940	366,706	3,306	4,277	
Net cash flow from ops pre changes in working capital	(4,322)	29,473	16,430	22,017	
Dec/(Inc) in trade and other receivables	(23,514)	(26,512)	1,194	1,545	
Inc/(Dec) in trade and other payables	25,781	18,296	(2,847)	(3,684)	
Net cash inflow/(outflow) from operating activities	(2,055)	21,257	14,777	19,878	
Payments for PP&E	(68,354)	(1,840)	(11,000)	(14,500)	
Proceeds from the sale of PP&E	92,436	-	-	-	
Other cash flows from investing activities	38,405	-	-	-	
Net cash flow from investing activities	62,487	(1,840)	(11,000)	(14,500)	
Issue of ordinary shares	6,017	-	-	-	
Proceeds from borrowings	18,000	-	-	-	
Repayment of borrowings and loan fees	(28,833)	-	-	-	
Interest and tax paid	(77,769)	72	(2,100)	(2,450)	
Net cash flow from financing activities	(82,585)	72	(2,100)	(2,450)	
Net inc/(dec) in cash and cash equivalents in the year	(22,153)	19,489	1,677	2,928	
Exchange and other effects	(5,714)	(18,101)	-	-	
Cash and cash equivalents at beg. of period	28,779	912	2,300	3,977	
Cash and cash equivalents at end of period	912	2,300	3,977	6,905	

Source: Company data, Edison Investment Research

Exhibit 2: Balance sheet

Y/E December	\$k	\$k	\$k	\$k	
Balance Sheet	FY 2008A	FY 2009E	FY 2010E	FY 2011E	Comments
Assets					
Non-current assets					
PP&E	336,968	66,000	72,089	81,705	
Other non-current assets	805,377	39,000	39,000	39,000	Includes \$34m loan to TYNGD, \$4m loan to shareholders
	1,142,345	105,000	111,089	120,705	
Current assets					
Trade and other receivables	132,190	6,500	7,694	9,239	
<i>as a % of sales</i>	59.5%	11.3%	11.3%	11.3%	
Cash and Cash equivalents	912	2,300	3,977	6,905	
	133,102	8,800	11,671	16,144	
Total Assets	1,275,447	113,800	122,760	136,849	
EQUITY					
Share capital	1,009	1,009	1,009	1,009	
Share premium account	640,080	640,080	640,080	640,080	
Translation difference and other	(40,216)	(13,755)	(15,855)	(18,306)	
Retained earnings	(251,045)	(564,234)	(556,021)	(543,165)	
Total equity	349,828	63,100	69,213	79,618	
Non-current liabilities					
Interest bearing loans and borrowings	34,359	-	-	-	
Current liabilities					
Interest bearing loans and borrowings	857,252	35,200	35,200	35,200	From 2009+ includes \$34m loan to Petraco
Trade and other payables	34,008	15,500	18,347	22,031	
<i>as a % of sales</i>	15.3%	27.0%	27.0%	27.0%	
	891,260	50,700	53,547	57,231	
Total equity & liabilities	1,275,447	113,800	122,760	136,849	
Balance Sheet Ratios					
	FY 2008A	FY 2009E	FY 2010E	FY 2011E	
Long-term financial debts	34,359	-	-	-	
Short term financial debts	857,252	35,200	35,200	35,200	
Gross debt	891,611	35,200	35,200	35,200	
Cash and cash equivalents	912	2,300	3,977	6,905	
Net debt / (cash)	890,699	32,900	31,223	28,295	
Ave Net debt / (cash)		461,800	32,062	29,759	
Net finance expense	(299,227)	(59,299)	(1,746)	(1,430)	
Financing costs (int. expense/ave. net debt)		12.8%	5.4%	4.8%	
Equity	349,828	63,100	69,213	79,618	
Gearing (Net Debt:Equity)	255%	52%	40%	30%	
Net debt/ EBITDA	(45.25)	(11.09)	1.94	1.30	
EBITDA / net interest expense (incl. lease expense)	(0.1)	(0.1)	8.5	13.4	

Source: Company data, Edison Investment Research

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