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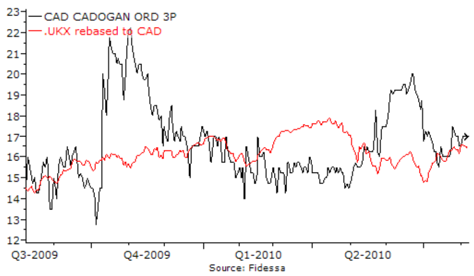
Cadogan Petroleum Plc £0.17

Adding value through production

23 August 2010

Share Price: £0.170



12m High: £0.340

12m Low: £0.125

Market Cap: £39.3m

Shares in Issue: 195,860,000

231,090,000 fully diluted

Debt: Nil

Cash at Hand £29.3m (27/04/10)

Current Net Production approx 530 boepd

One-off Receivables $37.5m (min)

LSE Code: CAD

Sector: Oil & Gas

Market: LSE

Website: www.cadoganpetroleum.com

Broker: UBS Investment Bank

Company Contact: 0207 2450801

Description: Independent E&P gas specialist operating in Ukraine with sufficient operating cash to meet all current commitments and advance exploration targets.

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Cadogan Petroleum Plc (LSE:CAD) is an independent oil & gas gas exploration and production company operating in Ukraine. It has had problems, technical, legal and managerial, and is continuing rebuilding investor confidence in its new management and operational structure following its wholesale re-organisation in 2009.

Successful completion and first production from the Zag-3 well at 35 mcm gas and 120 bbl/day condensate is great news for Cadogan's credibility as an oil and gas explorer and producer. It more than doubles their net attributable production from approx 230 boepb to 530 boepd at a very low cost.

Using average depletion rates from the rest of Cadogan's Dneiper-Donets portfolio of 30% pa for gas and 20% pa for condensate we have produced a provisional DCF10 valuation for 1P production from Zag-3 of $23m at the reported flow rates. Available data strongly suggests that higher flow rates are sustainable.

The receivables of $37.5m and cash at bank of £29.3 (27/04/10) and our NPV of 2P Reserves of $42.2m combine with this additional cash flow to provide a new NPV of £91.4m (46.7p/sh), against a background exchange rate change to $1.595:£1.00. Should, as we suspect they will, the higher flow rates be sustained an NPV of £97m (49.5p/sh) is warranted.

The eagle-eyed will notice that we have not reduced the 2P Reserves valuation by an amount commensurate to the new cash flow. Based upon the latest CGA CPR volumetrics current production from Zag-3 will only reduce 1C contingent resources by 0.03% in-place gas and around 5% condensate over its profitable lifetime. Until we have confirmation of the structural closure and re-establishment of those 3C resources back into 3P reserves we feel that the value of production from this resource will far outweigh the cost of depletion and give this valuation as a provisional guide.

We should remind readers that this still excludes the value of assets that remain under the farm-out process. We also suggest that bringing this asset into production allows Cadogan a greater degree of control over with whom it gets into bed and under what terms as a result of any successful farm-out.

The news that Cadogan is rapidly approaching break even will be a relief for shareholders and we will suggest that, barring extremely strange circumstances, the time has come to look forward rather than back. The NPV of production and pre-production assets is now roughly equal to cash plus non-production receivables as is only right for a growing E&P company.

Y/E	Group Sales	Declared Profit	Adjusted Profit	Adjusted EPS	P/E ratio	Divi	Yield
	£ 000s	£ 000s	£ 000s	£/sh		£	%
2008A	1,792	(24,877)	(34,363)	(0.17)	N/A	N/A	N/A
2009A	2,342	(107,303)	(118,680)	(0.46)	N/A	N/A	N/A
2010E			No	Estimates			
2011E			No	Estimates			

Conclusions

There are some points in the growth of a resources company that are worth of mention. First production is one, first profit is another. Cadogan appear to have found another; the point at which their conventional geological resource assets are worth as much as their non-production related receivables. Though it means very little in real terms it does indicate the company's direction and should come as a great relief to most of its shareholders. After all there are plenty of listed legal and accounting companies to own, but very few of them have the profit potential of an oil company in an emerging market.

Zag-3 value of $23m is provisional on confirmation of depletion rates

Our valuation of the Zag-3 well is provisional and, we believe, conservative. It is provisional because we do not yet know the probabilistic depletion rates for Zag-3. The three development scenarios for the Zagoryanske field given by CGA's CPR all use more than one well, so we have estimated the average depletion rates based upon Cadogan's other producing assets (all single wells in the same basin). The use of more than one well should allow higher overall recovery (or lower depletion rate) by water injection or other means of stimulation as well as constructive interaction between the pressure regimes of neighboring wells and lower infrastructure costs, so it may still be worth bringing in partners to de-risk wider development of this field though that will depend (as it always has) on the terms of any deal struck.

Higher flow rates look possible

The available data supports the conclusion that previous testing and completion of this well was far from optimal and that the reservoir is responding to good pressure management in the early stages of production. The suggested higher flow rate of 50Mcm/day gas at this point looks sustainable, but it is still early in the well's new production history to predict the exact balance between gas and condensate production.

Shifting Zag-3 straight into production has, by our estimates, added between $23m and $28.3m to the company's immediate value, whereas waiting for the production of another CPR to validate that move may have held the company back by 6 months or forced them into a hurried marriage in order to meet one of the larger development scenarios that are out of Cadogan's current price bracket. It may not be the absolute optimal solution as far as the petroleum engineers are concerned, but it significantly de-risks the farm-out process and will supply sufficient cash flow so that the company almost certainly breaks even next financial year (barring those ongoing legal costs).

Management now free to operate as an E&P company

Freed from the immediate threat of liquidation the management can now focus their attention and imagination on wealth creation. We believe that patient holders of Cadogan will start to see some returns in terms of capital appreciation from this point on as the company becomes what it always promised it would become; an oil and gas exploration and production company.

Emerging markets still have risks

There are still risks, as there are with any international venture into the emerging markets, but there are also opportunities, for example the proposed doubling of domestic gas prices in Ukraine and the possible continuation of geological formations prospective for shale gas over the border from Poland.

Upstep in valuation reflects move of asset out of the farm-out and into production

Cadogan and its assets look well placed to provide long-term value through production and our increase from 35.2p/sh to 46.7p/sh (or even 49.5p/sh) reflects the repositioning of a small portion of a 777Bcf 3C contingent resource that was under consideration for farm-out, and therefore not part of our previous valuation, onwards into production. The wider development of this field will probably still require partners and/or additional funds.

Management		**Major Shareholders**		
Non-exec Chairman	Simon Duffy	SAE Capital Holdings	67,298,498	29.10%
CEO	Ian Baron	QVT Financial LP	37,241,501	16.12%
Non-exec Director	Philip Dayer	HBK Capital Management	16,525,999	7.15%
Non-exec Director	Alan Cole	Lloyds TSB Group	14,841,482	6.42%
Non-exec Director	Nicholas Hooke	EBRD Ltd	11,632,866	5.03%
		JP Morgan	11,625,000	5.03%
Key Dates		**Key Milestones for 2010**		
Quarterly Reports	31st March, 30th September	- Completion of farm-out		
Half Yearly Report	31st December	-		
Annual Report	30th June			
Full Year Results	31st October			

Table 1: Key company data.

Cadogan Petroleum Plc

23 August 2010

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