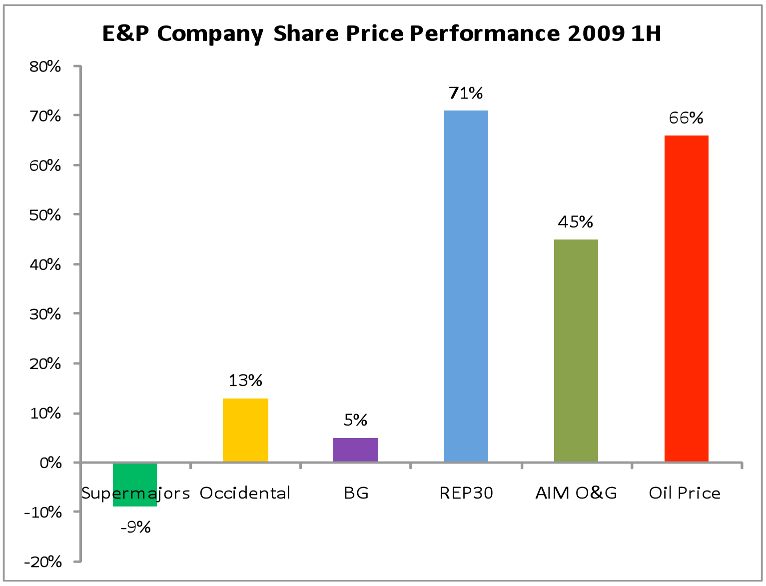
Richmond Energy E&P Market Summary

Small to Medium Cap Company Performance 20091H and Outlook for 2009 2H

Each year Richmond Energy Partners selects 30 small to mid-cap Exploration and Production companies (the REP30), operating largely outside North America, which we think have interesting assets in prospective areas. Through the year Richmond Energy tracks the progress of the REP30 and assesses growth prospects based on a judgment of the potential for production and reserves growth and exploration success.

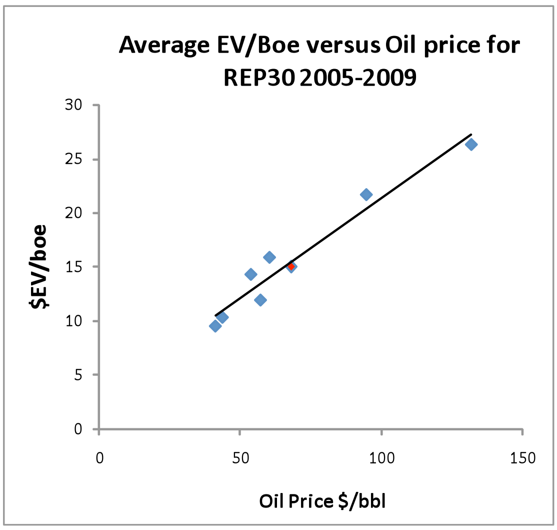


In the first six months of 2009, shares in REP30 companies are up an average +71% compared to a 66% rise in Brent crude oil price over the same period. The REP30 companies have comfortably outperformed both larger and smaller companies, spurred by production and reserves growth, exploration success and M&A activity. The share price rally accelerated from March as oil prices recovered.

This outcome reversed the pattern of 2008 when the E&P sector tracked oil prices lower as the global recession and credit crunch bit hard with the Supermajors losing less than the smaller companies as they were seen as a relative safe haven.

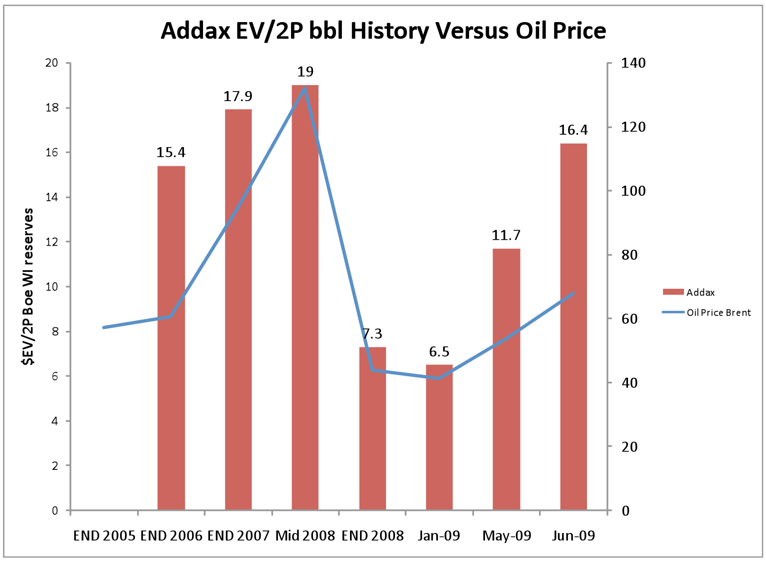
So given the rally in share prices, are the REP30 companies fairly valued by the markets and what is the outlook for the second half of 2009?

Are Current Valuations Still Supported by Fundamentals?



We can approach the question in a couple of ways – first, by looking at the enterprise value (EV) per barrel based on current equity valuations against oil price, and second by looking at recent transaction values.

There is a consistent relationship between the oil price and the average EV/boe of the REP30 companies over time (see figure to left). The current average EV/boe of the REP30 at $15/boe is in line with the historic relationship for an oil price of $60-70/bbl and is well below the $26/boe reached at the time of the oil price peak in mid 2008. So by this metric, we could argue that the REP30 is, on average, reasonably valued for the current oil price.



Another approach is to look at recent M&A transactions impacting REP30 companies. The sale of a company for cash is the acid test of what it is worth. Addax has accepted a bid from Sinopec which values it at an EV of $16.4/2P boe reserves ($65k per boe/d production capacity) - not far from the peak value of $19/boe in mid 2008 *(see figure to left)*. Note that Sinopec's $7.2bn bid compares to only $848M of equity capital deployed by Addax since start up in 1994. This equates to a remarkable year-on-year return on equity of 50%.

Addax's historic profitability is strongly correlated to oil price. Based on this correlation Addax would be expected to generate an after tax profit of $0/bbl at $40/bbl, $12.5/bbl at $80/bbl and $17.5/bbl at 100/bbl. At today's oil price, $16.4/boe seems a premium valuation and Addax has achieved a good price for its assets, benefiting from competition between two Asian NOCs.

Emirates National Oil Company (ENOC) have offered to buy out the 48% of Dragon Oil it doesn't own for a modest premium, valuing the company at ~$3bn. This values Dragon Oil's 636 mmbbl working interest 2P reserves in Turkmenistan at $3.3/bbl given its $875M cash and no debt. This looks cheap given Dragon delivered ~$19/bbl net income from each working interest barrel produced in 2008 but considerably more than ~$0.5/bbl it was valued at the end of 2008. The discount seems to reflect a perception of investor risk for a single asset company in a little understood country dominated by a NOC whose intentions are unclear.

In the UK, Centrica has indicated that it will offer £8.50/share for Venture Production valuing it at an EV of $10.1/boe, ($55k per boe/d) compared to a Venture's net income/boe of $6.6/boe in 2008. Venture itself sold a package of good quality gas assets to Nuon for $16.5/boe ($71k per boe/d) in June 2009, at a considerably higher price than the Centrica offer. The two distressed oil asset sales in the UK made in early 2009 - Premier's purchase of Oilexco ($12.6/boe, $37k per boe/d) and Dana's purchase of Bow Valley ($15.50/boe, $22k per boe/d) are useful comparative benchmarks at the low point in the market*. In mid-2008, Oilexco was valued at an EV/boe of $67.3.

In Australia, the sale of two different 10% equity stakes in the same field (Basker Manta Gummy) in February 2008, for $29.5/boe, and in May 2009 for $16.5/boe shows a decrease in asset value of 43%. This mirrors the average 42% decrease in average EV/boe of the REP30 from $26/boe to $15/boe over roughly the same period.

Recent transactions therefore also provide support for current equity valuations and demonstrate that a strong demand remains for quality upstream assets. Average equity values are not running significantly ahead of transaction values. The premium paid in acquisitions is reflective of the exceptions, either because assets are mis-priced by the market or the buyer is prepared to pay a strategic premium. Some companies, such as Tullow ($39/boe), are valued

* Note metrics shown do not include the benefits of tax losses which reduce the effective acquisition cost

much higher than average EV/bbl reflecting recent exploration success and in expectation of future reserves bookings.

Where is the oil price headed and how will it impact the REP30?

Having established the strong linkage between REP30 share performance and oil price, a key issue for investors is what is going to happen to oil prices next. Short term the market is oversupplied with the down turn in global demand, but this is balanced by longer term supply concerns. Medium to longer term the supply picture remains challenging for oil and upward pressure on prices is inevitable with the predicted resumption in demand growth. The uncertainty is in the cross-over between short-term speculation and the fundamentals of supply and demand. Further surprises cannot be ruled out.

Whilst not in the business of predicting oil price, safe to say we are not expecting oil price to be a particular catalyst for the REP30 in 2H2009.

Growth prospects for E&P companies

The REP30, together, are similar in size to a BG or Occidental but they have grown production and reserves more quickly. Continued growth for the REP30 companies depends on access to opportunity and access to capital. Growth capital is externally sourced for the most part and the financial crisis prompted concerns as to whether historic growth rates were sustainable given constrained debt markets.

The REP30 companies have raised $3.7bn in new equity in the first half of the year in order to fund major appraisal and development projects. The bad news is that companies need a lot more equity capital in the constrained post credit crunch debt markets. The good news is that institutions appear happy to invest. We have even seen a couple of non-REP30 companies raise significant equity for what we consider to be low-grade projects.

Nearly one third of the REP30 companies chose to issue new equity in 20091H, e.g. Tullow - $643M, Santos - $2210M, Premier - $250M, Afren - $126M. The large equity placings show that the funding gap left by diminished debt markets has to an extent been replaced by institutional equity investors. The rise in oil price has also relieved some of the pressure on E&Ps' balance sheets and companies are becoming more confident in committing to growth capital projects, especially as costs have begun to fall significantly. The more leveraged companies are not out of the woods yet as some have still to complete restructuring their balance sheets and would be vulnerable in low oil price scenarios.

There is no shortage of growth projects for the REP30 to invest in. We expect the REP30 companies to participate in up to 125 exploration and appraisal wells in the remainder of 2009 of which 40 are judged to have the potential to be high impact on the companies involved.

In conclusion

The REP30 companies' shares have outperformed their larger and smaller peers in first half 2009 as oil prices have rebounded. Current market valuations are in line with historic trends and appear to be supported by transaction values. In the second half of 2009, we are not expecting as much help from the oil price and further progress will be driven by the fundamentals such as production and reserves growth and exploration success. Given access to capital, E&P companies in the size range exemplified by the REP30 have a sufficient hopper of projects to continue to grow. However, investors need to be discriminating and focus on fundamentals as project quality will be key to out-performance.

For more information, go to our website www.richmondep.com.

Subscription Clients can download reports which give our judgements on:

- The future growth prospects for individual REP30 companies, e.g. 'REP30 Growth and Financial Risks Report'
- Quality of Exploration Programmes, e.g. 'REP30 High Impact Exploration Wells 2H 2009 Report'
- Exploration Hot Spots – Summaries of key geological basins, their potential, the below and above ground challenges and the companies involved
- Performance benchmarks – key performance metrics for REP30 companies – e.g. production, reserves, exploration track record, profitability and capital efficiency
- Company Insights - detailed looks at company portfolios, management capability and governance

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