18th July 2012

Oil price: a one-way bet?

Research Analyst

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Three stocks to tuck away

John Gapper of the FT reminds us that in 1999 The Economist declared we were ‘drowning in oil’, and considered whether oil prices would fall to US$5 a barrel. Come eight years later; oil at US$145 a barrel.

Thus highlights the pitfalls of oil price prediction. Indeed, it is probably true of all natural resources from water to food and metals that price prediction is hazardous especially in the short to medium term. What is not in doubt is the long term demand is on an upward trend, with resources becoming scarcer.

Dambisa Moyo is a Zambian born economist and has published her third book, titled ‘Winner Take All: The Race for the World’s Resources.’ Following on from her ‘Dead Aid’, preferring self-reliant development over western aid for Africa, she now warns of scarcity of resource: ‘The simple fact is that the world faces unprecedented constraints in natural resources: from arable land, to water, to minerals-and oil in particular.’ Advances in technology may delay the day of reckoning but she argues ‘it’s far from clear that they will do so forever.’

Against this background we have three Oil & Gas stocks to tuck away for the long term. One is a FTSE 100 stock, undervalued not just for recent exploration success, but grappling successfully with its future funding programme; a FTSE 250 producer, developer and explorer across the African continent and finally a small cap AIM explorer just turned producer/developer – the latter a more speculative buy.

- 18th July 2012

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BG Group

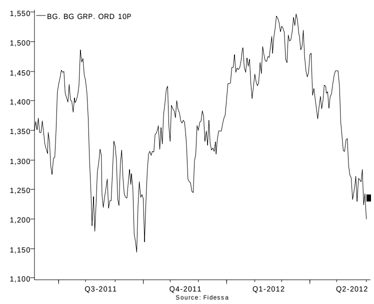
HB Markets

Buy

Price: 1,296.5p
Target: 1,800p

Ticker: BG.L
Index: FTSE-100
Sector: Oil & Gas Producers

Share Price Performance



Source: Fidessa

Key Data

12m high-low:	*1,554p-1,105p*
Mkt. cap:	*£41,356m*
No. of shares:	*3396.856m*
Website:	*bg-group.com*
Next results:	*Interims, Jul 2012*

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Undervalued market leader

BG Group continues to deliver both in exploration and appraisal success, and project delivery, maintaining its position as one of the industry's leading explorers, as well as meeting its milestones on funding.

- In Tanzania, a fourth consecutive success in this emerging new province raised the estimated gross mean recoverable resources to approaching some 7 trillion cubic feet of gas.
- Offshore Brazil, a new appraisal well confirmed the westerly extension of the Iara accumulation in the BM-S-11 concession, underlining the potential of the Group's interests in the world-class pre-salt Santos Basin.
- Fifth consecutive Tanzania gas discovery with the Mzia-1 exploration well located in Block 1, offshore southern Tanzania, announced 16th May 2012.

Four of the Groups 2012 projects were successfully brought on-stream and began production build-up:

- In Egypt, phase seven of the West Delta Deep Marine development was brought online;
- In offshore Norway, first production from the Gaupe field;
- in Thailand, new facilities at Greater Bongkot South began delivering volumes;
- in Bolivia, the first phase of production from the Margarita field commenced.

The Group say these new sources of production will, at plateau, add around 50 000 barrels of oil equivalent per day net to production.

Key financials

Year to December	***2009***	***2010***	***2011***	***2012e***	***2013e***
Revenue £m	*9,550*	*10,964*	*13,560*	*14,133*	*15,150*
Pre Tax Profit £m	*3,683*	*3,660*	*4,858*	*5,848*	*6,741*
EPS (p) Reported	*60.4*	*63.6*	*79.9*	*92.60*	*106.85*
Dividend per share(p)	*12.2*	*13.1*	*13.9*	*16.33*	*17.90*

Source: Hemscott Group Ltd

Group issued its 1st Quarter figures to 31 03 2012 on 3 May 2012 and posted a strong set of first quarter results with total operating profit up 21% to $2.4 billion, earnings up 55% to $1.3 billion and cash generated by operations up 47% to $2.6 billion.

Exploration and production business delivered a 5% increase in volumes and total operating profit for Liquefied Natural Gas (LNG) business was up 42% to

$812 million, boosted by continuing strong demand from Asian markets.

On major projects the Group is making rapid progress in Brazil with the development of the big five Santos Basin discoveries. A fourth producing well has been connected to Floating production storage and offloading (FPSO) 1 and the construction and conversion programmes for the further 12 FPSOs continue to advance providing tangible progress towards 2.3 mmboe per day of installed capacity by 2017.

In Australia, the Group has increased drilling capacity as planned and delivered over 70 wells in the quarter; Significant upstream contract awards for facilities and infrastructure are progressing. At the LNG plant on Curtis Island, dredging continues to progress to schedule; construction of the two LNG storage tanks is ongoing; and the first of 47 modules from Thailand is due for delivery in the second half of 2012. Despite cost pressures, the project remains firmly on track for first LNG in 2014.

Funding Programme

The Group has agreements for over US$3 billion capital release from $5 billion programme. A definitive binding agreement has been signed for the sale of the Group's entire 60.1% share in Comgás to Cosan SA Industria e Comercio Brazil's largest gas distribution company, for $1.7 billion, at current exchange rates. In addition, the deal will reduce debt on the Group balance sheet by circa US$1.1bn.

Also, there is an agreement for sale of 40% share in GNL Quintero for up to $352 million. The Group's 8% shareholding in Senex Energy Limited was sold for $78 million. At the end of May 2012, the Group had reached an agreement to sell its 40% equity interest in two gas-fired power generation plants in the Philippines to its partner in the facilities, First Gen Corporation, for net cash proceeds of $360 million. The execution of the funding plan was complemented by an agreement with Export Development Canada for a credit facility of $500 million and, also, by the acceptance of a funding facility from the Brazilian Federal Development Bank (BNDES) for up to US$1.8bn.

In June 2012 the company issued a three currency (S, $ and Euro) hybrid bond issue raising US$2.07bn. The new bonds, which have a coupon of 6.5%, have the same principal terms and conditions as the sterling and euro issues and mature on the same date in 2072. The hybrid bonds are long-dated, subordinated securities, which are treated partially as equity by credit rating agencies, further strengthening and diversifying BG Group's balance sheet. BG Group has a right to repay the bonds on certain dates before maturity, the first occurring in November 2017. BG Group Executive Director & Chief Financial Officer Fabio Barbosa said: "We are pleased with this issue of hybrid bonds which have been well received by investors, with both the sterling and euro books substantially oversubscribed. The bonds add further diversification to the Group's funding types and help underpin investment in our significant growth opportunities, such as those in Brazil and Australia. During this capital-intensive period, we remain committed to a strong balance sheet and the success of today's issue demonstrates a clear endorsement of our plans by investors."

Current Issues

18th July 2012

BG Group

Elgin Franklin shut down by Total March 2012 following on-going gas leak
Elgin and Franklin are two high pressure/high temperature gas and condensate fields, which started production in 2001. They are located in the British North Sea, approximately 240 kilometres east of Aberdeen, in Scotland. The Elgin field was discovered in 1991 and the Franklin field in 1986.

Total operates these fields and increased its stake to 46.17 percent in late 2011. Other stakeholders include ENI (21.86 pct), British Gas (14.11 pct), and E.ON Ruhrgas (5.2 pct). The rest is owned by several smallholders.

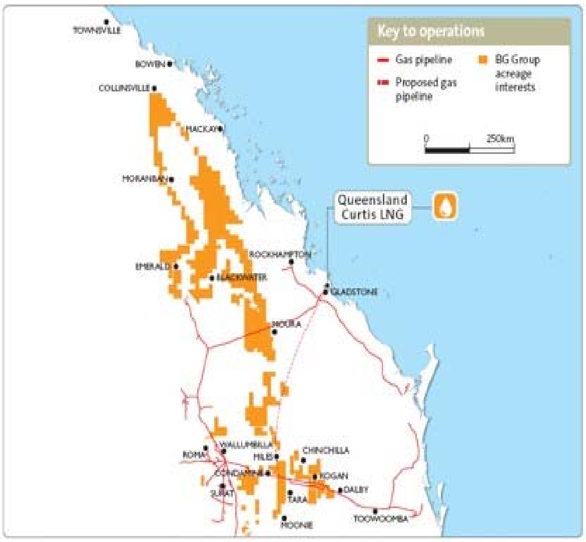
In Mach 2012, Total shut down production following a gas leak and sources indicate it could take six months to stop the leak. BG Group's share represents 1-2% of 2012 volume growth. All personnel were moved to a place of safety.

Valuation

Exploration and development

a) BG Group has delivered 5 high impact exploration successes in Tanzania, and, relative to its market cap such success is not fully reflected in the current valuation. Furthermore, additional high impact exploration news could be the catalyst for a re-rating.
b) The Brazilian Assets are not yet fully reflected in the current valuation
c) The LNG business in the medium term offers excellent exposure to potential earnings.

The Queensland Curtis LNG (QCLNG) project
QGC is developing coal seam gas in the Surat Basin of southern Queensland for domestic and export markets through its Queensland Curtis LNG (QCLNG) Project.



The project draws on QGC's extensive coal seam gas expertise and BG Group's international experience in liquefied natural gas (LNG) at a time of rising demand for cleaner, more efficient energy.

Importantly, QCLNG is also helping to address climate change by allowing natural gas, which has the lowest carbon emissions of all fossil fuels, to be transported economically around the world. Plans include expanding QGC's existing coal seam gas production in the Surat Basin of southern Queensland and building a 540km buried natural gas pipeline network linking the gas fields to Gladstone. In addition, construction of a natural gas liquefaction plant on Curtis Island, near Gladstone, where the gas will be converted to LNG for export. The project's first stage will comprise two processing units, known as LNG trains, at the Curtis Island plant. These trains, which have a design life of at least 20 years, will produce a combined 8.5 million tonnes of LNG a year.

The site can accommodate an expansion to 12 million tonnes of LNG a year, subject to demand. Construction started in 2010, with the first LNG delivery expected in 2014. Market developments indicate a secured 10mtpa of LNG sales, in high value Asia-Pacific markets. QCLNG capital spend to 2014 has increased by 19%, impacted by regulatory compliance, ongoing local market and a busy construction environment. However, cost pressures are mitigated by early implementation of and contracting strategy. Upstream unit capital expenditure of $9/boe and with first LNG delivery on track for 2014. Currently producing less than 25,000 boe net that net plateau production circa 215,000 boe from first phase during 2015 and beyond.

Brazil Floating platform, storage & offloading (FPSO) progress

FPSO 1 has 5 connected wheels, of which 4 are producers and one is a CO2 disposal well. FPSO 2 is 85% complete, FPSO 3 is 75% complete with the next two on target at circa 15%. FPSO 3 is on route to Brazil.

Costs

Low technical costs- leased with Capex at $5/boe and operating expenditure $9/boe and purchased FPSOs at Capex $7/boe and opex

BG Group's net reserves & resources

From less than 3bn boe in 2008 over 5bn boe in 2011 with upside to circa 7.5bn

Strengths and weaknesses

Strengths	***Weaknesses***
• *Exploration success;* • *Development success;* • *Funding in place.*	• *Major recession or significant political upheaval in our major markets;* • *Failure to ensure the safe operation of our assets;* • *Fluctuations in oil and/or gas prices;* • *Foreign exchange risk;* • *Technical, development, environmental, commercial, economic, legal, regulatory and country risk.*

Source: HB Markets

18th July 2012

Afren

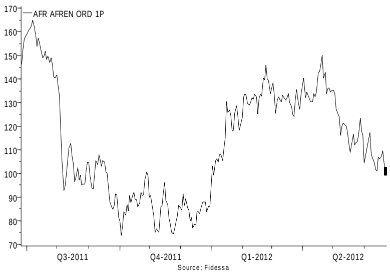
HB Markets

Buy

Price: 118.4p
Target: 200p

Ticker: AFR.L
Index: FTSE 250
Sector: Oil & Gas Producers

Share price performance



Source: *Fidessa*

Key Data

12m high-low	*169p-72.25p*
Mkt. cap:	*£1,095m*
No. of shares:	*1074.91m*
Website:	*afren.com*
Next results:	*Interims, Aug 2012*

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Exploration success not reflected in valuation

Successful 2012 Exploration Wells:

- Ebok North Fault Block (Ebok NFB) exploration well encountered 370 ft true vertical thickness (TVT) of net oil pay in excellent quality reservoir sands-data shows 100mbo-towards the company's pre-drill expectations (May 2012)
- Okoro East exploration well, offshore south east Nigeria, has made a new oil discovery having encountered 549 ft true vertical thickness (TVT) of net oil pay and 41 ft of net gas pay in excellent quality reservoir sands (Jan 2012). Based on the test data the Company expects future horizontal production wells at Okoro East will be capable of yielding between 4,500 to 7,000 bopd per well. The Company will drill two production wells using existing facilities in H2 2012 and up to 8 production wells, under a full field development scenario(March 2012)
- Simrit-2 exploration well, located on the Ain Sifni PSC in the Kurdistan region of Iraq, has discovered a significant oil accumulation based on the results of drilling, wireline logs and sidewall core sampling (April 2012)-drilling deeper ahead of testing

With an excellent start to the 2012 exploration programme and with Q1 production in line with expectations, generating US$300m of net cash flow, the shares are on a prospective PE of 5.2x and are substantially undervalued.

Financials

Year to December, £m	***2009***	***2010***	***2011***	***2012e***	***2013e***
Revenue	*208*	*204*	*384*	*867*	*848*
Pre tax profit	*0.30*	*50*	*142*	*447*	
EPS (p)	*-1.30*	*3.50*	*7.53*	*21.56*	*17.07*

Source: **Hemscott**

Afren

About Afren

Afren is an exploration and production company – listed on London's Main Market and a constituent of the FTSE 250. The company has a portfolio of 29 assets in 12 countries and spans the full-cycle E&P value chain of exploration, appraisal, development through to production and is located in several of the world's most prolific and fast emerging hydrocarbon basins.

The Company Assets

Nigeria

Indigenous independents well represented in terms of license interests held but under represented today in terms of commercial reserves and production. Resource ownership and production dominated by the five major International Oil Companies (IOC's). Large number of discovered but undeveloped fields with significant upside potential and opportunities exist for an aligned partner to provide technical and financial capacity.
Multiple low risk/high value opportunities already within Afren's portfolio (Okoro East, Ebok/Okwok/OML 115, OML 26)

Okoro field development

Working with a local partner**,** Amni International, Afren oil production achieved within two years of entry (2008). They have drilled 9 production wells to date and production continues at ca. 16,000 bopd gross from existing well stock. The company is moving towards the 3P recovery scenario. The Okoro East discovery transforms outlook from volume and value perspectives-Okoro reservoirs- P90 19mmbbls; P10 86mmbbls; with unrisked P10 upside to 329mmbbls; 30-40% recovery factor

Ebok field development

Again working with a local partner, Oriental Energy Resources, an appraisal campaign more than quadrupled gross 2P reserves to >100 mmbbls (NSAI) and within 21/2 years first oil achieved in 2011. All wells associated with the initial development phases commissioned by December 2011 and performance in line with prognosis and production stabilised. Successful partnership created follow on opportunities nearby at Okwok and OML 115

OML 26 onshore

Acquisition of 45% interest through First Hydrocarbon Nigeria (Afren a 45% shareholder). Total entry and appraisal cost of US$1.0 per 2P/2C bbl. Large scale re-development opportunity at Ogini and Isoko with existing infrastructure in place. Production at completion 6,000 bopd; increased to 10,500 bopd at end 2011. Appraisal upside and Multiple low risk exploration opportunities

Strategic entry to the Kurdistan region of Iraq

Transferring a core production and development skill set developed in Nigeria

Reservoir evaluation studies have identified 1.43 billion barrels of recoverable 2P + 2C oil resource in multiple reservoirs. Approximately 500 million barrels of light oil is the target for initial phases of development. The remaining resource is heavier oil and will be the focus of appraisal and pilot testing prior to formulating a development plan.

Transforming the reserves base

- Only 19% of total discovered resource potential is in production or under development
- 58 years reserves and resources life based on 2012E production

Milestones

Ebok

- Drill and complete four production wells in 2012
- Use production history to define future infill targets
- Drill out prospective upside (Ebok North)

Okoro East

- Drill and complete two production wells in 2012
- Longer term full field development (up to eight further wells)

Okwok

- Drill one appraisal well in 2012
- FDP submission

OML 26

- Continue to optimise output from existing well stock
- Commence drilling of new horizontal production wells
- Expand surface production capacity

Barda Rash

- Re-entry and completion of existing three wells in 2012 (10,000 to 15,000 bopd gross)
- Commence drilling of multiple new production wells to develop light oil reserves
- Define optimal development of heavier oil resources

Strategic entry into East Africa

Exploration portfolio acquired 2010-Kenya, Ethiopia, Madagascar

The transaction completed October 2010 via share for share exchange -US$104.8 million in Afren paper or acquired for US$0.08/unrisked bbl. These are for high impact exploration portfolio in Ethiopia, Kenya, Madagascar and the Seychelles. Acquisition delivered a complementary portfolio extension and high growth opportunities to leverage Afren's stable production platform. Transaction has unlocked further East African opportunities – Tanzania, Tanga Block (March 2011). Recent acquisitions well in excess of Afren's entry cost:

- Recommended cash bid offer accepted for Cove of 220 pence per share US$1.8 bln (2012)by Shell, upped to 240p by PTT

- Sale of 33% stage in Uganda (Lake Albert block) to CNOOC for US$1,467mm (201

- Acquisition of Dominion Petroleum (assets in Kenya and Tanzania) by Ophir Energy for US$186mm in an all stock deal (2012)

- Tullow signs agreements with Africa Oil and Centric Energy to gain a 50% operated interest in five Kenya licences and one Ethiopian licence. Tullow to reimburse past costs and will carry Africa Oil for future net expenditures up to US$23.75mm (2010)

- BG acquires 60% of Ophir's interests in Blocks 1, 3 and 4 offshore southern Tanzania by contributing 85% funding of a drilling and seismic program (2010)

Conclusion

An unparalleled track record of acquisitions

1. **Previous Sub Saharan Africa acquisition costs for 2P/2C is US$18/bbl for West African comparables vs:**

- Okoro $2/bbl
- Ebok $1.9/bbl
- Okwok $1.2/bbl
- OML 26 $1.0/bbl

2. **Kurdistan region of Iraq** -p**recedent transaction cost US$5.2bbl vs:**

- Afren acquisition cost-US$0.7/bbl

There is no doubt that Afren has an enviable track record of buying exploration assets cheaply, exploiting them successfully to production. There is plenty more to come from the Company. At the current valuation, one can imagine majors looking enviously at their portfolio.

Strengths and weaknesses	
Strengths	***Weaknesses***
• *Track record - Exploration; Acquisitions; Development and Delivery;* • *Not expensive;* • *Management, knowledge of area and industry;* • *Many projects with International major oil companies.*	• *Exposed to politically volatile African regions, although well spread geographically;* • *Development and exploration risks-past performance not necessarily a guide to future;* • *World GDP growth may slow;* • *Oil price may fall.*

Source: HB Markets

18th July 2012

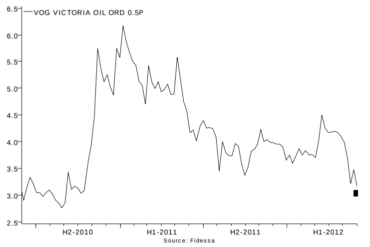
Victoria Oil & Gas

Speculative Buy

Price: 2.59p
Target: 9p

Ticker: VOG.L
Index: AIM
Sector: Oil & Gas Producers

Share price performance



Source: *Fidessa*

Key Data

12m high-low	*4.8p-2.99p*
Mkt. cap:	*£82.8m*
No. of shares:	*2,706m*
Website:	*victoriaoilandgas.com*
Next results:	*Prelims, Oct 2012*

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Gas Deliveries Imminent

The company has completed and commissioned the second stage of the pipeline to, and around, central Douala, the pre-eminent industrial city of Cameroon. A total of 13.2km of pipeline has been installed and commissioned, providing the Company with access to more than 20 large industrial energy consumers. The company has raised £3.15m by way of an equity placing and US$1.2m draw down of loan finance and renewal of an existing Standby Equity Distribution Agreement-to be used as a bridge to positive cashflow, long-term debt funding of production operations in Cameroon, accelerate the customer conversion process and enable operational flexibility.

First gas deliveries were anticipated in the June, with revenues following in July, and this was confirmed on 9th July. Initial sales of circa 1 million cubic feet per day (mmcf/d) are anticipated in the first instance and the Company expects to build this up to 8 mmcf/d by the end of 2012 and a target by end 2014 of 44mmscf/d. Favourable hydrocarbon prices secured-equivalent to US$96boe. Other catalysts to assist in rerating would be additional sales agreements to better utilise the field; ultimately gas supply to a large independent power producer or third party LNG facility.

Overview

Cameroon

- VOG owns 95% of the Logbaba gas & condensate field - State 5%
- Gross 2P reserves: 39.5 million barrels of oil equivalent (mmboe) - 212 billion cubic feet (Bcf) gas plus 4.2 million barrels (mmbbls) condensate
- Gross best estimate prospective resources: 1,000 Bcf
- Two successful appraisal wells completed in 2010
- Awarded Exploitation Licence by Presidential Decree in April 2011
- 2011 - First onshore gas producer in Cameroon

Russia

- VOG owns 100% of West Med gas and condensate project
- Adjacent to large existing production in Siberia
- Best estimate prospective resources: 1.4 bnboe
- 2P reserves 1:14.4 mmboe
- Farm-in partner interest and option

Valuation: Target Price 9p

The Company is valued on 2P reserves at US$2.7/boe against African producer median of US$16.7boe. There is substantial upside as gas revenues begin to increase through 2012 and beyond. However, there is a development risk in Cameroon, despite pipeline being delivered on time, so a more realistic target price is 9p.

Company Strategy

- Become a mid-size E&P player through organic growth and acquisition by 2015
- Focus on core areas of West Africa and the Former Soviet Union (FSU)
- Build on cash flow from Logbaba to fund further exploration and development opportunities
- Become a leading player in new thermal and power projects in Cameroon
- Acquire companies/assets with significant reserve and production potential
- Opportunistic, undervalued assets/distressed sellers
- Acquire high impact exploration assets (onshore/near shore assets)
- **Net 2P Reserves have risen from 26mmboe in 2009 to 52mmboe in 2011and**
- **Net Best Estimate Prospective Resources risen from 1,122mmboe in 2009 to 1,594mmboe in 2011**

Cameroon Market

Customer Specific Benefits

- Energy demand is met by high-cost imported fuels (diesel and fuel oil)
- Petrol and diesel costs are equivalent to UK
- Natural gas creates approx. 30% total cost savings
- Contract savings per unit of energy
- Improved boiler efficiencies and longer life through reduction of scaling and soot
- Reduced pumping, storage and heating costs
- Reduced maintenance costs and less downtime

Benefits for Cameroon

- Cameroon challenged with constant blackouts and brownouts hampering expansion
- Advance of gas and certainty of supply will pave the way for increased industrial expansion and foreign direct investment
- Douala, located on the Western seaboard, is one of Africa's most important trade centres and a major hub for Central Africa
- Working with the government to facilitate new power projects driven by existing incumbents and new IPP projects
- Post-2014, potential expansion in to mini-LNG & possible integration with major mining projects
- Environment benefits; gas thermal energy of choice with less emissions.

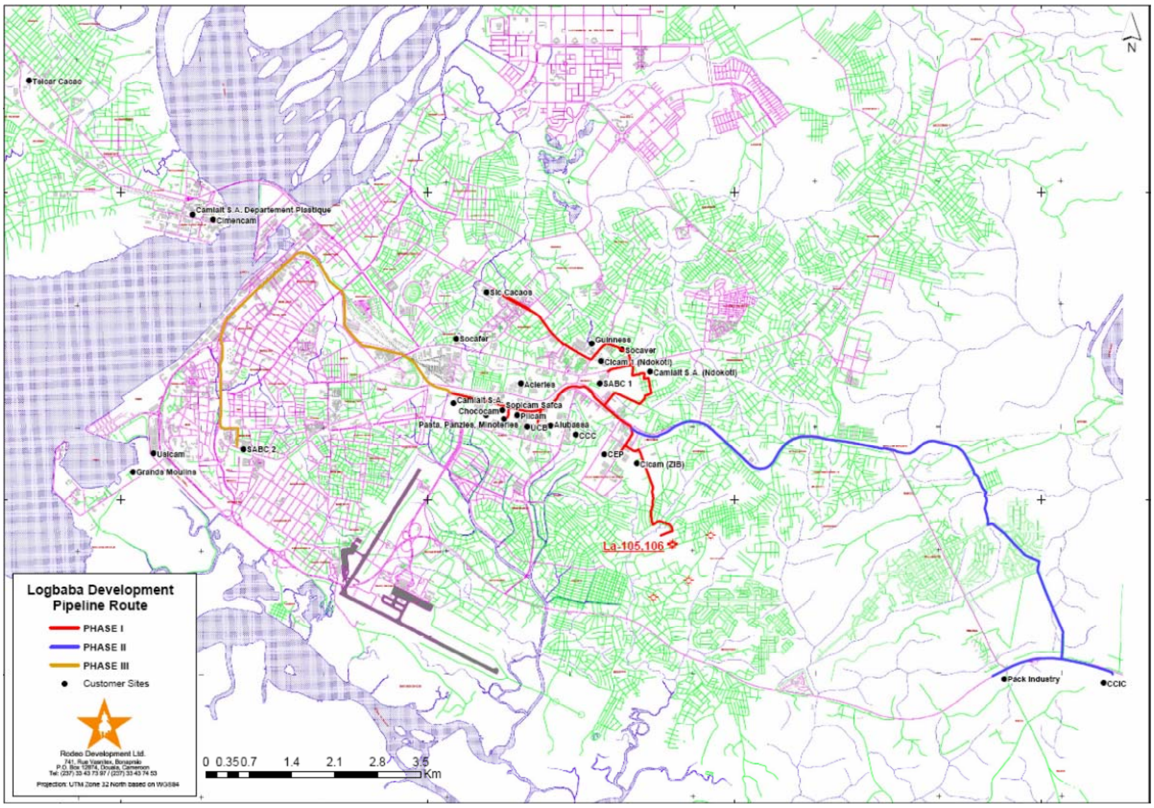
Logbaba Reserves

Results from petroleum consultant Blackwatch Petroleum Services in October 2010

Analysed seismic, well logs and test data from La-105 & La-106 and original four wells:

- Gross Proved Reserves (1P) increased five-fold from July 2008 study to 49 Bcf + 1.0 mmbbls of condensate
- Gross Proved plus Probable (2P) reserves increased two fold to 212 Bcf + 4.2 mmbbls of condensate
- Gross Prospective Resources evaluated to be in excess of 1 Tcf + 20 mmbbls of condensate

Figure 1 Douala with the pipelines 1 & 2 highlighted in red and blue; approximately 85% of industrial market within 10km of the gas wells, marked LA 105, 105



Logbaba: Exploration Upside

According to the company, the best potential location on the structure has yet to be drilled

- Majority of the block remains unexplored
- In 2009, a passive seismic survey was commissioned
- Significant new structure 4 km north of the current well sites located in the industrial area
  - Surface location will be chosen to minimise disruption

In 2011 VOG announced the forfeiture by RSM Production Corporation of its 38% interest but they failed to pay their cash call on 15th June 2011. Victoria Oil & Gas took legal advice before taking action.

West Med, Russia: Land of Super-Giants

West Med lies adjacent to the super-giant Medvezhye and Urengoy fields

- 20-year Exploitation Licence granted for West Med after discovery well of 14.4 mmboe with Well 103
- September 2011 - Independent reserve auditors Mineral LLC announce 300 mmboe increase in gross prospective resources to 1.4 bnboe (previous estimate by D&M in 2006 1.1 bnboe)
- 670 mmbbls of oil
- 730 mmboe of gas & condensate

Work In-Progress/Forward Plans

- Conceptual screening and development studies in progress to commercialise West Med large
- prospective resources and to exploit the Well 103 discovery to generate cash flow
- Submit drilling locations in Q1 2012 to the Russian MNR for two wells in 2012
- Plan for drilling to start in Q4 2012

Little if any value for the above is included in valuation and should be regarded as 'blue sky'.

Strengths and weaknesses	
Strengths	***Weaknesses***
• *Imminent revenue generation;* • *Ramp up in output over 2 years;* • *Further exploitation and exploration potential;* • *Fulfils industry need;* • *Plenty of capacity for target sales by 2014.*	• *Gas flow in Cameroon maybe lower than anticipated;* • *Customers in Douala may take longer to sign up;* • *Costs to connect may escalate;* • *RSM legal action is possible despite VOG taking legal advice;* • *Exploration of assets in Russia may not happen.*

Source: HB Markets

Recommendations
During the three months to end-June 2012, the number of stocks on which HB Markets has published recommendations was 158, and the recommendations were as follows: Buy - 80; Hold - 60; Sell - 17. Full definitions of the recommendations used by HB Markets in its publications and their respective meanings can be found on our website here.

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