

10 November 2008

# Buru Energy

## Beaten by the wet

Change of target price

### Buy

**Important:** The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

### High volatility

**Target price**  
A\$0.74 (from A\$0.77)

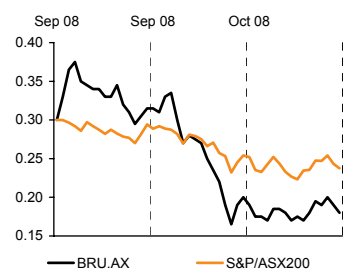
**Price**  
A\$0.18

**Short term (0-60 days)**  
n/a

BRU81110

### Price performance

	(1M)	(3M)	(12M)
Price (A\$)	0.23	n/a	n/a
Absolute (%)	-23.4	n/a	n/a
Rel market (%)	-12.7	n/a	n/a
Rel sector (%)	-7.6	n/a	n/a



**Market capitalisation**  
A\$29.18m (US\$19.56m)

**Average (12 mnth) daily turnover**  
A\$0.36m (US\$0.28m)

RIC: BRU.AX, BRU.AU  
Priced at close of business 7 Nov 2008.  
Source: Bloomberg

### Analyst

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**Workovers of Blina and Sundown increased production from 30bopd to 200bopd and BRU participated in one high-risk exploration well that was plugged and abandoned.**

### Key forecasts

	FY08A	FY09F	FY10F	FY11F
EBITDA (A\$m)	-9.99	-4.29 ▲	-3.74 ▲	-3.00 ▲
Reported net profit (A\$m)	-3.02	0.61 ▲	0.85 ▲	1.22 ▲
Normalised net profit (A\$m) <sup>1</sup>	-3.02	0.61 ▲	0.85 ▲	1.22 ▲
Normalised EPS (c) <sup>1</sup>	-1.86	0.38 ▲	0.52 ▲	0.75 ▲
Normalised EPS growth (%)	n/a	n/a	37.8	44.2
Dividend per share (c)	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00
Normalised PE (x)	n/m	47.5	34.5	23.9
EV/EBITDA (x)	5.49	12.8	14.7	18.6
Price/net oper. CF (x)	0.31	28.3 ▼	24.3 ▼	19.2 ▼
ROIC (%)	0.00	20.1	18.1	15.2

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

year to Jun, fully diluted

1. Pre non-recurring items and post preference dividends

Accounting standard: IFRS

Source: Company data, ABN AMRO Morgans forecasts

### The September quarter - exploration and production

Buru Energy (BRU) was formed with the demerger from ARC Energy and listed on the ASX on 1 September. Under the terms of a gas sales agreement novated to BRU with Alcoa's approval, Alcoa advanced A\$40m for exploration of BRU's Canning Basin tenements. BRU is obligated to deliver 400 BCF of gas to the Dampier end of the Dampier-Bunbury gas pipeline. Exploration of the Canning Basin to satisfy this agreement remains BRU's focus. To this end it participated in the high-risk well, Lanagan 1 (35%), which was plugged and abandoned during the quarter after failing to intersect hydrocarbons. BRU also completed workovers on the Blina and Sundown oil complex, increasing production from 30bopd to about 200bopd and improving cash flows, but exploration remains the primary focus.

### Since the end of the quarter

BRU inconclusively tested Stokes Bay #1 (BRU 39%), which lost circulation in porous Devonian reef, with gas and a well-head pressure anomaly reported, but which was not fully evaluated at that time. During the test the fluids lost during drilling were not fully recovered and the source of the gas bled from the well during the test remains uncertain. The results will be evaluated before any further testing. A second high-risk exploration well, Lawford 1 (BRU 35%), was spudded, but was suspended 300m short of the primary objective with the risk of the onset of wet weather.

### The forward program - drilling after The Wet

Paradise #1 will test a four-way dip closure, 10km west of Valhalla #1, which penetrated oil and gas zones, but where instability problems prevented testing. The Paradise structure offers scope for a +100 BCF resource. Valhalla remains a valid prospect for testing in 2009. Pictor # 1 reported 2.2mcfpd, accompanied by 30 barrels of oil, gas and water when drilled in the 1980s. At that time an independent review suggested the in-place resource was in excess of 140m boe in a tight reservoir. Rather than redrilling Pictor, BRU intends to test the reservoir at the Pictor East structure, which has the potential to host 1m-5m boe. The Yulleroo #2 well, drilled by ARC in 2008, reported 30m of net potential gas-bearing sands over a 170m interval and 400m up-dip from Yulleroo #1. A drill stem test of these zones failed when the perforating guns failed - the well was suspended and cased for testing and evaluation as a potential gas producer, anticipated in 2009.

## Valuation and risks

We have lowered our target price and valuation from A\$0.77 to A\$0.74 to reflect unsuccessful exploration expenditure to date.

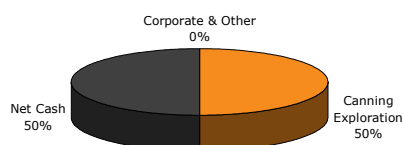
Key risks to our target price to the upside are drilling success resulting in the creation of shareholder value, while to the downside, failure will erode cash and lower the value of the exploration acreage.

BRU has A\$82.6m in cash, with A\$62.6m in free cash – about A\$0.39 per share. The balance of A\$20m (a further A\$0.12 per share) is held in escrow for Alcoa. BRU has minor oil production from the Blina field, and owns and operates the Fairway rig, suitable for workovers, and which is expected to be modified for slim-hole exploration drilling. The company has three recently drilled but untested gas discoveries to evaluate, which, if successful, could enable it to move towards reserve definition to satisfy the Alcoa GSA. BRU has a number of other oil and gas prospects and leads, within 140,000 square kilometres covering the greater Canning, with hydrocarbon potential. Realising value will depend on achieving exploration success within the A\$62m exploration budget.

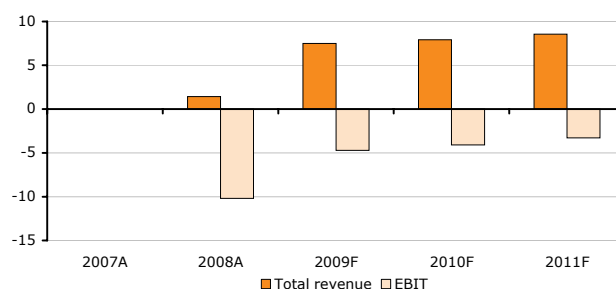
**BRU – financial summary**

Year to 30 Jun (US\$m)	AIFRS	AIFRS	AIFRS	AIFRS	AIFRS	Price target (A\$)	0.74
Income statement	2007A	2008A	2009F	2010F	2011F	Valuation (A\$)	\$ 0.74
Divisional sales	0.0	1.1	2.3	1.7	1.4		
Total revenue	0.0	1.4	7.5	7.9	8.6	<b>Valuation summary</b>	<b>A\$m</b> <b>A\$ps</b> <b>DCF valuation inputs</b>
EBITDA	0.0	-10.0	-4.3	-3.7	-3.0	Canning Exploration	60.0 0.37 Rf 5.75%
Depreciation & amortisation	0.0	-0.2	-0.4	-0.4	-0.3	Net Cash	60.0 0.37 Rm-Rf 4.50%
EBIT	0.0	-10.2	-4.7	-4.1	-3.3	Corporate & Other	0.0 0.00 Beta 1.54
Net interest expense	0.0	5.9	5.6	5.3	5.0	<b>Total valuation</b>	<b>120.0</b> <b>0.74</b> CAPM (Rf+Be) 12.7%
Pre-tax profit	0.0	-4.3	0.9	1.2	1.7		Tax rate (t) 30.0%
Income tax expense	0.0	1.3	-0.3	-0.4	-0.5		<b>WACC</b> 10.14%
After-tax profit	0.0	-3.0	0.6	0.8	1.2		Shares 162.1
Minority interests	0.0	0.0	0.0	0.0	0.0		
NPAT	0.0	-3.0	0.6	0.8	1.2	<b>Production (Mt)</b>	<b>2008A</b> <b>2009F</b> <b>2010F</b> <b>2011F</b>
Significant items	0.0	0.0	0.0	0.0	0.0	Oil (mmbbl)	0.00 0.02 0.02 0.02
NPAT post abnormalities	0.0	-3.0	0.6	0.8	1.2	Gas (mmcf)	0.00 0.00 0.00 0.00
<b>Growth ratios</b>	<b>2007A</b>	<b>2008A</b>	<b>2009F</b>	<b>2010F</b>	<b>2011F</b>	<b>Key assumptions</b>	<b>2008A</b> <b>2009F</b> <b>2010F</b> <b>2011F</b>
Sales growth		0%	108%	-25%	-21%	USD / AUD exchange rate	0.89 0.94 0.93 0.89
Operating cost growth	n.m.	n.m	-41%	-17%	-20%	Oil Price (US\$/bbl)	94.32 104.06 90.00 80.00
						Gas Price (A\$/Gj)	7.39 6.60 5.82 5.63
<b>Cash flow statement</b>	<b>2007A</b>	<b>2008A</b>	<b>2009F</b>	<b>2010F</b>	<b>2011F</b>	<b>Per share data</b>	<b>2008A</b> <b>2009F</b> <b>2010F</b> <b>2011F</b>
EBITDA	0.0	-10.0	-4.3	-3.7	-3.0	No. shares	162.1 162.1 162.1 162.1
Cash flow from ops (1)	0.0	94.1	1.0	1.2	1.5	EPS (cps)	-1.9 0.4 0.5 0.8
Capex (2)	0.0	-10.0	-1.0	-1.0	-1.0	EPS (normalised) (c)	-1.9 0.4 0.5 0.8
Disposals/acquisitions	0.0	0.0	0.0	0.0	0.0	Dividend per share (c)	0.0 0.0 0.0 0.0
Cash flow from invest (3)	0.0	-10.0	-1.0	-1.0	-1.0	Dividend payout ratio (%)	0.0 0.0 0.0 0.0
Incr/(decr) in equity	0.0	0.0	0.0	0.0	0.0	Dividend yield (%)	0.0 0.0 0.0 0.0
Incr/(decr) in debt	0.0	0.0	0.0	0.0	0.0		
Ordinary dividend paid	0.0	0.0	0.0	0.0	0.0	<b>Operating performance</b>	<b>2008A</b> <b>2009F</b> <b>2010F</b> <b>2011F</b>
Other financing cash flow	0.0	0.0	0.0	0.0	0.0	EBIT growth	n.m. -54% -13% -20%
Cash flow from fin (5)	0.0	0.0	0.0	0.0	0.0	NPAT growth	n.m. -54% -13% -20%
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Normalised EPS growth	n.m. n.m. 38% 44%
Incr/(decr) cash (1+3+5+6)	0.0	84.1	0.0	0.2	0.5	Asset turnover (%)	0.5 0.5 0.4 0.3
Equity FCF (1+2)	0.0	84.1	0.0	0.2	0.5	EBITDA margin (%)	-897.5 -185.7 -217.3 -219.2
						EBIT margin (%)	-916.3 -203.9 -238.0 -241.4
<b>Balance sheet</b>	<b>2007A</b>	<b>2008A</b>	<b>2009F</b>	<b>2010F</b>	<b>2011F</b>	Net profit margin (%)	-271.6 26.6 49.2 89.3
Cash & deposits	0.0	84.0	84.0	84.2	84.8	Return on net assets (%)	-16.4 -7.5 -6.5 -5.1
Trade debtors	0.0	0.0	0.0	0.0	0.0	Net debt (A\$m)	-84.0 -84.0 -84.2 -84.8
Inventory	0.0	0.1	0.1	0.1	0.1	Net debt/equity (%)	-135.5 -134.2 -132.7 -131.0
Investments	0.0	0.0	0.0	0.0	0.0	Net interest/EBIT cover (x)	1.7 0.8 0.8 0.7
Other intangible assets	0.0	0.0	0.0	0.0	0.0	ROIC (%)	0.0 20.1 18.1 15.2
Fixed assets	0.0	1.5	2.1	2.7	3.4		
Other assets	0.0	26.5	26.5	26.5	26.5	<b>Comparable multiples (x)</b>	<b>2009F</b> <b>2010F</b> <b>2011F</b>
Total assets	0.0	112.1	112.7	113.6	114.8	Buru Energy	EV/EBITDA 11.4 13.0 15.8
Interest bearing debt	0.0	0.0	0.0	0.0	0.0	Year to 30 Jun	PE 104.6 54.3 32.4
Trade payables	0.0	0.0	0.0	0.0	0.0		
Long-term borrowings	0.0	0.0	0.0	0.0	0.0	Texon Petroleum	EV/EBITDA -12.2 2.2 1.9
Provisions	0.0	10.1	10.1	10.1	10.1	Year to 31 Dec	PE -24.6 8.0 8.4
Other liabilities	0.0	40.0	40.0	40.0	40.0		
Total liabilities	0.0	50.1	50.1	50.1	50.1	Amadeus Energy	EV/EBITDA 2.0 1.1 0.5
Share capital	0.0	63.4	63.4	63.4	63.4	Year to 30 Jun	PE 3.5 2.9 2.9
Other reserves	0.0	0.0	0.0	0.0	0.0		
Retained earnings	0.0	-1.4	-0.8	0.1	1.3	<b>Earnings Sensitivity</b>	<b>2009F</b> <b>2010F</b> <b>2011F</b>
Total equity	0.0	62.0	62.6	63.5	64.7	Gas sensitivity (+10%)	0.43 0.72 0.67
Minority interest	0.0	0.0	0.0	0.0	0.0	Gas sensitivity (+10c Gj)	0.05 0.09 0.09
Total shareholders' equity	0.0	62.0	62.6	63.5	64.7	USD sensitivity (+10%)	0.41 0.18 -0.43
Total liabilities & SE	0.0	112.1	112.7	113.6	114.8	USD sensitivity (+10c)	0.05 0.02 -0.05

**Operations valuation breakdown**



**Total revenues and EBIT (A\$m)**



Source: Company data, ABN AMRO Morgans forecasts

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Absolute performance, short-term (trading) recommendation: The Trading Buy/Sell recommendation implies upside/downside of 3% or more. The trading recommendation time horizon is 0-60 days.

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