

## Oil &amp; Gas

## BUY

## Incremental Petroleum Limited

## Edirne drilling update

## KEY POINTS

- IPM is currently drilling the Arpaci-2A well, which is the last well in the five well drilling campaign at the Edirne Gas project in north western Turkey.
- All wells drilled in the current campaign have successfully intersected gas and IPM has already flow tested two of the wells.
- The two wells tested to date, Ikiyoyuk-1 and Kuzey Arpaci-1, returned flow rates of 3.8mmcf/d and 2.8mmcf/d respectively.
- These tests compared favorably with the initial wells drilled at Edirne in 2007, Bati Umur-1 and Koyutsu-1, which flowed at 3.6mmcf/d and 2.0mmcf/d respectively.
- In mid May IPM acquired eight exploration concessions in central Turkey that have the potential to contain up to 150mmbbls of oil and/or 1.0TCF of gas.

## COMMENT

Drilling at Edirne is proceeding as planned with the last of the five wells nearing completion. Two wells have been successfully flow tested with the Ortakci-1 and Arpaci-2A wells yet to be tested. We note that the Arpaci-2 well encountered unusually high gas pressures at 169m and as a safety measure will not be tested. The Arpaci-2A well is being drilled at a 30m offset to the Arpaci-2 well and is expected to be flow tested in coming weeks.

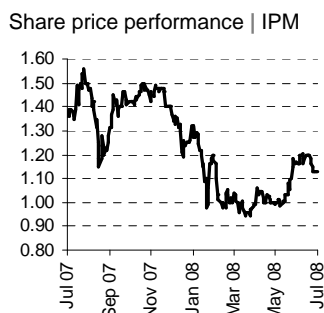
A total of four wells have been successfully flow tested at Edirne with a combined rate of 12.2mmcf/d. While we do not expect the test rates to fully reflect production rates, we note that our development scenario for the Edirne Gas Project assumes six wells are brought into production in mid 2009 at a combined rate of 9.0mmcf/d (1.5mmcf/d per well). With two wells yet to be tested and a number of 3D seismic defined targets yet to be drilled, we are confident that our initial production rate for Edirne is appropriately conservative.

## INVESTMENT VIEW

IPM's core cash flow generating asset is its 100% owned Selmo Oil field in south-eastern Turkey. The project has 11.3mmbbls in 2P reserves and is currently producing around 450,000bbls per year. Selmo is expected to generate around \$20Mpa in cash flow over the next two to three years which will enable IPM to undertake its planned development programs in Turkey and California and also continue to pay unfranked dividends.

Development drilling at Edirne is proceeding as planned and we expect the project to commence gas production in mid 2009. IPM has a 55% interest in the project and is the operator. Based on an initial production rate of 9.0mmcf/d, Edirne should generate around \$10Mpa of cash flow for IPM.

We are reiterating our BUY recommendation on IPM and have upgraded our price target on the company from \$1.66/share to \$1.85/share to reflect some upgrades to our commodity price assumptions. Solid production from Selmo should underpin IPM's share price while further development news at Edirne and the newly acquired US projects provide significant upside potential for the stock.



Year end December	2007A	2008F	2009F	2010F
Revenue - A\$M	40.0	53.7	69.9	75.4
EBITDA - A\$M	18.3	29.2	38.6	41.4
NPAT - A\$M	10.8	17.5	23.3	24.7
Free Cash Flow - A\$M	(5.1)	2.9	6.8	27.5
EPS - cents	16.0	23.0	29.7	29.1
EPS - % chg	(10.9)	43.6	29.4	(2.2)
PER - x	7.1	4.9	3.8	3.9
DPS - cents	6.0	7.0	9.0	12.0
Dividend Yield - %	5.3	6.2	8.0	10.6
Franking - %	0.0	0.0	0.0	0.0

Notes: 1. Price target is equivalent to our DCF valuation.

Year end December 2007A 2008F 2009F 2010F

### PROFIT & LOSS SUMMARY (A\$M)

<b>Sales revenue</b>	<b>40.0</b>	<b>53.7</b>	<b>69.9</b>	<b>75.4</b>
Other revenue	0.6	0.4	0.4	1.3
Operating Costs	(19.5)	(21.8)	(28.7)	(32.2)
Exploration Expense	0.0	0.0	0.0	0.0
Corporate & Admin	(2.8)	(3.0)	(3.0)	(3.1)
<b>EBITDA</b>	<b>18.3</b>	<b>29.2</b>	<b>38.6</b>	<b>41.4</b>
Depreciation	(4.2)	(3.7)	(4.8)	(5.6)
<b>EBIT</b>	<b>14.1</b>	<b>25.5</b>	<b>33.8</b>	<b>35.8</b>
Interest Expense	(0.1)	(0.5)	(0.5)	(0.5)
<b>Pre-tax profit</b>	<b>14.0</b>	<b>25.0</b>	<b>33.3</b>	<b>35.3</b>
Tax expense	(3.2)	(7.5)	(10.0)	(10.6)
<b>Net income</b>	<b>10.8</b>	<b>17.5</b>	<b>23.3</b>	<b>24.7</b>
Minorities & Abnormals	0.0	0.0	0.0	0.0
<b>NPAT</b>	<b>10.8</b>	<b>17.5</b>	<b>23.3</b>	<b>24.7</b>

### CASHFLOW SUMMARY (A\$M)

NPAT	10.8	17.5	23.3	24.7
Int, Tax, Expl Expensed	3.3	8.0	10.5	11.1
Int, Tax, Expl Incurred	(5.1)	(13.4)	(20.6)	(11.9)
Depreciation/Amortisation	4.2	3.7	4.8	5.6
Working Capital (Inc)/Dec	(2.4)	(0.1)	(0.6)	0.1
Other	0.7	0.0	0.0	0.0
<b>Operating Cash Flow</b>	<b>11.5</b>	<b>15.7</b>	<b>17.4</b>	<b>29.6</b>
Capex(net of asset sales)	(10.0)	(5.3)	(5.1)	(2.1)
Disposals/(Acquisitions)	(6.7)	(7.6)	(5.4)	0.0
Other investing cash flows	0.0	0.0	0.0	0.0
<b>Free Cash Flow</b>	<b>(5.1)</b>	<b>2.9</b>	<b>6.8</b>	<b>27.5</b>
Dividends	(2.0)	(5.2)	(5.5)	(8.3)
New Equity	(3.4)	8.6	0.0	11.5
Debt Drawdown/(Repay)	5.9	0.0	0.0	0.0
<b>Net Cash Inc/(Dec)</b>	<b>(4.6)</b>	<b>6.2</b>	<b>1.3</b>	<b>30.7</b>
FX impact on cash	0.4	0.0	0.0	0.0
Cash at End Period	3.8	10.0	11.3	42.0
<b>Net Cash/(Debt)</b>	<b>(2.6)</b>	<b>3.6</b>	<b>4.9</b>	<b>35.6</b>

### BALANCE SHEET (A\$M)

Cash	3.8	10.0	11.3	42.0
Receivables	7.9	10.7	17.5	18.8
Inventories	2.2	5.4	7.0	7.5
Other current assets	0.6	0.5	0.7	0.8
<b>Total current assets</b>	<b>14.5</b>	<b>26.7</b>	<b>36.5</b>	<b>69.1</b>
Plant & equipment	17.6	17.8	17.8	17.5
Oil & Gas properties	60.5	69.5	75.3	72.1
Other non-current assets	11.6	11.3	11.1	10.9
<b>Total non-current assets</b>	<b>89.7</b>	<b>98.6</b>	<b>104.2</b>	<b>100.4</b>
<b>Total assets</b>	<b>104.2</b>	<b>125.3</b>	<b>140.6</b>	<b>169.6</b>
Payables	3.7	7.0	9.1	9.8
Short-term debt	1.3	1.3	1.3	1.3
Other current liabilities	0.1	1.1	1.4	1.5
<b>Total current liabilities</b>	<b>5.1</b>	<b>9.3</b>	<b>11.8</b>	<b>12.6</b>
Long-term debt	5.1	5.1	5.1	5.1
Other non-current liabilities	15.8	9.6	3.0	1.8
<b>Non-current liabilities</b>	<b>20.9</b>	<b>14.8</b>	<b>8.1</b>	<b>7.0</b>
<b>Total liabilities</b>	<b>26.1</b>	<b>24.1</b>	<b>19.9</b>	<b>19.6</b>
<b>NET ASSETS</b>	<b>78.1</b>	<b>101.2</b>	<b>120.8</b>	<b>150.0</b>
Contributed equity	56.3	64.8	64.8	76.3
Retained profits	21.9	36.3	55.9	73.7
Minority interests	0.0	0.0	0.0	0.0
<b>EQUITY</b>	<b>78.1</b>	<b>101.2</b>	<b>120.8</b>	<b>150.0</b>

Year end December 2007A 2008F 2009F 2010F

### RATIOS AND MULTIPLES

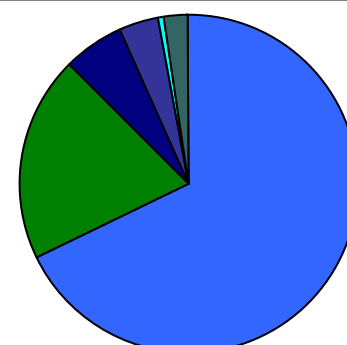
<b>Income</b>				
Revenue growth   %	(1.8)	34.3	30.2	7.9
EBITDA growth   %	(10.1)	59.4	32.3	7.1
EBITDA margin   %	45.8	54.4	55.3	54.9
EBIT margin   %	35.3	47.5	48.4	47.5
Effective Tax rate   %	23.1	30.0	30.0	30.0
Net interest cover   x	120.7	51.0	67.7	71.6
<b>Balance Sheet</b>				
ROA   %	10.3	14.0	16.6	14.6
ROE   %	13.8	17.3	19.3	16.5
Net debt/equity   %	3.4	(3.6)	(4.0)	(23.7)
Net debt/(debt+equity)   %	3.3	(3.7)	(4.2)	(31.1)
<b>Shares Outstanding</b>				
Basic   M	67.4	78.6	78.6	87.4
Other   M	8.8	8.8	8.8	0.0
Fully diluted   M	76.2	87.4	87.4	87.4
<b>Valuation metrics</b>				
Market cap   M	86.1	98.7	98.7	98.7
Net debt (cash)   \$M	2.6	(3.6)	(4.9)	(35.6)
Options   \$M	9.9	9.9	9.9	0.0
Enterprise value   \$M	98.7	105.1	103.8	63.2
<b>EV/EBITDA   x</b>	<b>5.4</b>	<b>3.6</b>	<b>2.7</b>	<b>1.5</b>
EPS   c	16.0	23.0	29.7	29.1
P/E   x	7.1	4.9	3.8	3.9
FCF / Share   c	(7.6)	3.6	8.6	31.5
<b>Price / FCF   x</b>	<b>na</b>	<b>31.1</b>	<b>13.1</b>	<b>3.6</b>
Dividend Yield   %	5.3	6.2	8.0	10.6
Franking   %	0.0	0.0	0.0	0.0

### VALUATION

<b>NPV by project</b>	<b>(A\$M)</b>	<b>(A\$/sh)</b>
Selmo Oil Project	111.1	1.27
Edirne Gas Project	32.3	0.37
Regional Anticline	9.6	0.11
Basin - West Side	6.4	0.07
Other Projects	1.0	0.01
Unpaid capital	11.5	0.13
Corporate	(16.8)	(0.19)
Exploration	3.6	0.04
Forwards	0.0	0.00
Cash	9.9	0.11
Debt	(6.4)	(0.07)
<b>NPV @ 12%</b>	<b>162.0</b>	<b>1.85</b>

### NPV BY PROJECT

- Selmo Oil Project
- Edirne Gas Project
- Regional Anticline
- Basin - West Side
- Other Projects
- Exploration



Year end December      2007A    2008F    2009F    2010F

### PRODUCTION SUMMARY

Oil Production (mmbbls)				
Selmo Oil Project	501	465	442	426
Regional Anticline	0	0	60	57
<b>Total</b>	<b>501</b>	<b>465</b>	<b>502</b>	<b>482</b>
Oil Production (bopd)				
Selmo Oil Project	1,374	1,275	1,212	1,167
Regional Anticline	na	na	164	155
<b>Total</b>	<b>1,374</b>	<b>1,275</b>	<b>1,376</b>	<b>1,322</b>
Gas Production (mmcf)				
Eirne Gas Project	0.0	0.0	901.1	1,868.1
Basin - West Side	na	na	na	na
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>901.1</b>	<b>1,868.1</b>
Gas Production (mmcf/d)				
Eirne Gas Project	na	na	2.47	5.12
Basin - West Side	na	na	na	na
<b>Total</b>	<b>na</b>	<b>na</b>	<b>2.47</b>	<b>5.12</b>

### CASH COSTS

Cash Costs (US\$/bbl)				
Selmo Oil Project	32.3	43.9	44.4	41.7
Regional Anticline	na	na	44.5	41.5
<b>Average (US\$/bbl)</b>	<b>32.3</b>	<b>43.9</b>	<b>44.4</b>	<b>41.7</b>

### Cash Costs (US\$/mcf)

Eirne Gas Project	na	na	3.36	3.22
Basin - West Side	na	na	na	na
<b>Average (US\$/mcf)</b>	<b>na</b>	<b>na</b>	<b>3.36</b>	<b>3.22</b>

### COMMODITY PRICE ASSUMPTIONS

Year end December	2007A	2008F	2009F	2010F	Long-term
WTI Oil (US\$/bbl)	72.32	119.05	117.39	104.09	70.00
Arabian Oil (US\$/bbl)	67.61	107.94	106.55	94.58	66.00
Arabian Gas (US\$/mcf)	7.11	10.98	10.76	10.14	9.00
US\$/A\$ FX	0.84	0.93	0.91	0.86	0.80

### BOARD OF DIRECTORS

Chris Cronin	Non-Executive Chairman
Gerry McGann	Managing Director
Mark Stowell	Non-Executive Director
Clayton Hyder	Non-Executive Director
Jonathan Asquith	Chief Financial Officer

### SUBSTANTIAL SHAREHOLDERS

Shareholder	Shares (M)	(%)
Westoz Funds Management	5.4	6.9%
Paradice Coopers Investors	4.6	5.9%
Kinetic Investment Partners	4.6	5.9%
<b>Top 20</b>	<b>37.5</b>	<b>47.7%</b>

### RESERVES AND RESOURCES

Reserves		
<b>1P Reserves</b>	<b>100%</b>	<b>IPM</b>
Selmo	5.9	5.9
<b>Total</b>	<b>5.9</b>	<b>5.9</b>
<b>2P Reserves</b>	<b>100%</b>	<b>IPM</b>
Selmo	11.3	11.3
<b>Total</b>	<b>11.3</b>	<b>11.3</b>
<b>3P Reserves</b>	<b>100%</b>	<b>IPM</b>
Selmo	18.4	18.4
<b>Total</b>	<b>18.4</b>	<b>18.4</b>

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