

Dragon Oil

United Kingdom/Oil & Gas Producers
Investment Research

Buy

Recommendation unchanged

Share price: GBp 446.50

closing price as of 02/11/2009

Target price: GBp 805.00

vs Target Price: GBp 540.00

Reuters/Bloomberg DGO.L/DGO.LN

Daily avg. no. trad. sh. 12 mth 1,867,087

Daily avg. trad. vol. 12 mth (m) 0.08

Price high 12 mth (GBp) 446.50

Price low 12 mth (GBp) 121.25

Abs. perf. 1 mth 19.1%

Abs. perf. 3 mth 33.1%

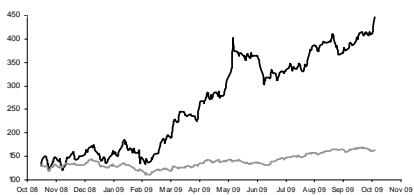
Abs. perf. 12 mth 179.9%

Market capitalisation (GBpm) 2,302

Current N° of shares (m) 516

Free float 48%

Key financials (USD)	12/08	12/09e	12/10e
Sales (m)	706	617	862
EBITDA (m)	624	524	736
EBITDA margin	88.3%	84.9%	85.4%
EBIT (m)	474	306	485
EBIT margin	67.1%	49.7%	56.3%
Net Profit (adj.)(m)	369	254	385
ROCE	44.5%	29.9%	41.8%
Net debt/(cash) (m)	(876)	(1,035)	(1,327)
Net Debt Equity	-0.6	-0.6	-0.7
Net Debt/EBITDA	-1.4	-2.0	-1.8
Int. cover(EBITDA/Fin.int)	(24.9)	(16.2)	(25.6)
EV/Sales	0.4	4.4	2.8
EV/EBITDA	0.5	5.2	3.3
EV/EBITDA (adj.)	0.5	5.2	3.3
EV/EBIT	0.6	8.9	5.0
P/E (adj.)	3.2	14.8	9.8
P/BV	0.8	2.3	1.9
OpFCF yield	54.4%	12.4%	18.7%
Dividend yield	0.0%	0.0%	0.0%
EPS (adj.)	0.72	0.49	0.75
BVPS	2.80	3.22	3.89
DPS	0.00	0.00	0.00



Source: Factset

For company description please see summary table footnote

Slaying the Dragon ? Not for 455p !

We estimate that ENOC's bid for Dragon Oil at 455p generates an overly generous 25% IRR for ENOC, excluding the additional benefit of accessing nearly a billion dollars of cash almost immediately for a cash outlay of \$1.9bn. We think that trying to capture this level of excess return will trigger critical re-valuation rather than passive acceptance, and a wider recognition that the discount to the value as a standalone entity is too wide.

- ✓ We estimate that of Dragon's stand-alone value is 805p. This is increase from the 540p we thought would be acceptable to minority shareholders, which was based on a 20% return which we feel adequately reflects ENOC's controlling position. Without such a level of internal returns allowed to an acquirer, we discount the same cash flows at a risk-adjusted cost of capital of 12%, in line with our valuation methodology of other E&P assets in similar areas of political or geological risk.
- ✓ In practice, we believe this long term value might not take so long term to be realised. We have never expected, and still would not expect, any competing bid against ENOC, who we expect to have a clear run at Dragon provided they provide reasonable rewards to minority investors. However, we think rejection of this offer of such asymmetric reward opens a different scenario, where having failed to access Dragon's highly attractive cash mountain and future cash flows for such a limited outlay, the government of Dubai may instead see ENOC's stake as a more readily fungible asset, achieving a premium for its controlling stake in assets which have greater strategic value to other energy players. We see no shortage of interest in access to producing assets in central asia, especially given the flexibility of direction of delivery. Furthermore, we believe those lending to Dubai may also start to look to the emirate to contribute towards its recovery rather than engage in growth at this period.
- ✓ This note explains the mechanics of the Scheme of Arrangement, and the critical element of the requirement to achieve a vote of 75% in favour from the minority shareholders. This means in practice that shareholders representing just 12.2% of the total shareholding will be sufficient to block the deal. Indeed, given Dragon Oil's long tail of small shareholders, the threshold is probably even lower. We think the deal is a long way from being in the bag.
- ✓ ENOC does not bring operational, managerial or financial synergies to Dragon Oil which would be lost in the event of withdrawal. In fact, all ENOC bring is its existing 51.5% stake, a fact which gives it critical but not inevitable advantage, and for which investors would concede significant but not wildly excessive returns. We see the downside as limited: voting against a deal which still goes through still leaves the shareholder with selling at 455p; voting against in sufficient numbers to block the deal leaves Dragon exposed to a short period of decline as special sits investors etc move out, but we see wide support for Dragon and significant latent demand waiting for a dip we think will now be shallower given the attempt by ENOC

Dragon remains one of the cheapest E&P stocks in our coverage at the 455p offer price. We believe investors will be unwilling to relinquish their positions at such a discount, and the mechanics of the deal mean that those who see ENOC's success as inevitable will be encouraged to hold out for fairer standalone value.

Analyst(s): Peter Hutton

+44 207 071 5227 p

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Mechanics of the deal – Main Questions and Answers

What are the critical stages of the Scheme of Arrangement ?

- Advantage of the Scheme for an acquirer is a lower approval threshold - but 12.2% of the total shareholder base can still block the deal

One of the advantages of achieving a positive recommendation from the target company is that the takeover becomes a company-led process, under which Dragon Oil itself (as opposed to ENOC) can apply for a Scheme of Arrangement, which requires approval from 75% of the minority shareholders rather than the 90% threshold required under the formal takeover bid procedure from ENOC.

However, with the 51.5% of the shares already held by ENOC excluded from the vote, approval must be confirmed by 75% of the remaining 48.5% of the shares in ownership, ie 36.4%.

This means that shareholders accounting for 12.2% of the total ownership have the ability to block the deal if they vote against the proposal at the first court meeting (including voting by proxy). To the extent that not all shareholders vote (and there is a long tail of smaller shareholders), this percentage could be even lower.

- Formal offer document – within the next 28 days

Having announced the recommended Acquisition, the company has 28 days in which to publish the formal Offer documentation. The “Scheme Document” will be detailed and can take some time to prepare, but we do not expect further material information in this document which has not already been provided, and we expect that this document could be published in the next few days.

The timing is likely to be driven by indications on when there is a slot for the first meeting in the Irish Court, given the requirement for there to be an interval of at least 21 days between the posting of the document and the shareholder meetings. We think the offer document could be published towards the end of this week or early next, with a view to holding the shareholder meetings early in December.

- First Court Hearing

We would expect that during the next few days, the company will petition the court for permission to convene the various meetings required to receive approval to implement the scheme

- Court meetings – at least 21 days after posting of Scheme Document

This is the most significant step of the Scheme of Agreement, as acceptance would be gained if 75% of those shares voting (ie independent shareholders) are in favour of the proposed bid.

ENOC is not able to use its 51.5% shareholding in favour of the recommendation, so this requires 75% of the remaining votes. Any holders who wish to block the offer must actively vote against the proposal, as abstentions do not default either in favour or against the proposal.

This means that in practice there is little to be gained for ENOC to buy shareholding in advance of the court hearing, as it would reduce the level of minorities and therefore the threshold required to prevent a 75% vote in favour. For example, if ENOC were to buy an additional 10% stake, approval would require 75% of 38.5%, and the level required effectively to block approval would fall to 9.6%.

Votes can be made by proxy, and we understand may be changed up to 48 hours in advance of the scheduled court meeting. After that, it may be possible still to change voting if an approved representative attends the court in person.

▪ **Extraordinary General Meeting – same day as court meetings**

If approval is gained by 75% of the votes by shareholding, the company can call an Extraordinary General meeting which must vote through the necessary structural approvals required for the deal to be executed, eg changes in articles of association, cancellation of shares etc.

We understand that according to Dragon's articles, a two-thirds majority is sufficient, but if the independent shareholders vote in favour of the scheme at the court meetings, then we would expect the EGM to be a formality.

▪ **Second court hearing – mid December to Early January ?**

This is required formally to complete the process, by implementing the instructions from the EGM and court meetings. At this meeting, the Company will petition the Court to sanction the Scheme that would have been approved by shareholders.

▪ **Deadline for completion**

Implementation of the acquisition is conditional on the scheme becoming effective by no later than 29th March 2010, (or possibly a later date with the consent of the Irish Takeover Panel and High Court).

The press release states that Dragon, ENOC and their advisors aim to complete the full process by January 2010.

We do not see the timing as a particularly significant issue.

For us, the critical element is the requirement to achieve the 75% threshold in the vote for the first court meeting. In practice, the ability of 12% of the existing shareholder register effectively to block the deal means this is far from being in the bag.

What are the implications of the undertakings in the release – and those absent?

■ ENOC undertaking not to accept an offer for its shares until 10 August 2010

As part of the discussions with the Independent Committee, ENOC has made an irrevocable undertaking not to sell or accept any offer for its Dragon Oil shares for a twelve month period commencing on 10 August 2009.

We understand that the purpose of this undertaking was to provide reassurance that ENOC would not be able to buy out the minorities shareholders of the company and then very quickly sell them on to a third party at higher value.

We see two implications arising from this undertaking: 1) a recognition that there is indeed a wider market interest in Dragon Oil and its assets, which the present 51.5% holding by ENOC effectively blocks but which could otherwise be realised; and 2) we understand that this undertaking may be contingent on the deal, and would lapse if the deal was not approved by the necessary 75% of independent shareholders.

This may be significant, as we believe that if ENOC is unable to realise the high value we see at its offer of 455p, it might open the prospect of the Dubai government (owners of ENOC) realising value instead for its 51.5% stake in Dragon. Given the level of financial constraint in the Emirate and the funds being raised to support (or perhaps rescue) other companies, we believe some of those outside Dubai who are being asked to provide those funds may put some pressure on Dubai to realise some of its more fungible assets, of which its stake in Dragon is one.

■ Irrevocable undertakings from members of the Independent Committee

The three directors who form the Independent Committee of Dragon have undertaken to vote their shares in favour of the recommended bid. However, this represents only 125,000 shares, a mere 0.024% of the share capital of Dragon Oil, which we see as immaterial.

■ No mention of other irrevocable undertakings...

At this stage, it is not unusual for some announcements to state that the bidder had already received an undertaking in support of the offer. (In practice, it would have been permissible for Dragon to contact major shareholders after Friday's close). The benefit of this is that it can demonstrate momentum behind the deal from the time of first announcement. Any such undertaking must be declared in the announcement so have not been received, and we believe at this stage have not yet been initiated.

■ No undertaking from ENOC not to raise bid

It is allowable (and has been practice in some announcements) for the acquirer to confirm / undertake that it will not make any revised offer for the company. The advantage of this, especially in the specific circumstances of the ENOC bid where we do not see the practicality of any direct competing bid, would have been to emphasise that this is the final offer. That ENOC has not made such an undertaking can be seen as providing some "wobble room" raise the bid from the 455p announced, but we would see any upside as limited, given the time taken to get to this level and the reliance on external funding (stated as coming from Standard Chartered Bank and National Bank of Dubai).

▪ **Dragon agreement to reimburse ENOC expenses**

Dragon Oil has entered an Expenses Reimbursement Agreement, under which it will pay specific quantifiable third party costs incurred by ENOC in connection with acquisition, up to a maximum of 1% of the value of the shares which are subject to the Acquisition multiplied by the cash consideration (ie up to \$11.5m).

Although not a large sum, such an agreement is relatively unusual in circumstances where the acquirer is actively interested in pursuing a bid, and is more usually associated with companies who are trying to elicit a bid.

Given that ENOC's bid are already likely to be relatively low for a bid of this scale (limited due diligence and external confirmation given that ENOC are already the major shareholder and indeed share the same head offices), this agreement further reduces ENOC's up-front cost commitment to the deal, and lowers its sunk cost / "walk away" point.

This compounds our impression that ENOC are overly-exploiting their existing position to propose a relatively low bid, and if it fails to succeed leaves it with an opportunity cost but little real cost.

Why have we raised our Target price to 805p ?

▪ **Basis of previous Target Price at 540p**

On 7th September, we raised our Target Price from 435p to 540p. This was based upon our long term oil price of \$85 and a discount rate of 20%.

We believe that 20% IRR (excluding the time value benefit of ENOC accessing the nearly \$1bn of cash on Dragon's balance sheet represented a fair, even generous return to ENOC on their acquisition which would have been acceptable to minority shareholders. We think that by trying to acquire the minorities at too great a discount will be counter-productive, triggering critical re-evaluation rather than more passive acceptance

▪ **ENOC's offer at 455p represents a hefty 25% IRR, excluding the added value of immediate access to Dragon's cash reserves**

Assuming the same returns on gas, we estimate that the bid of 455p is equivalent to an NAV of \$9.30 on Dragons Net Entitlement reserves of 296 million barrels.

2P Oil Reserves		296
Contingent Gas Reserves	During licence period	222.7
Total Reserves		518.7
Oil \$/bbl	9.30	2752.8
Gas \$/boe	2.00	356
Value of Reserves \$/boe	5.99	3109
Cash \$m		875
Term Deposits		0.0
Fair Value including Net Debt	\$m	3984
Long term \$/£		1.70
Market Cap	£m	2344
Shares out		515.0
Implied Price	pence	455

Using our net cash flow models, this represents an extremely attractive 25% IRR for ENOC, excluding the additional time value of immediate access to Dragons \$1bn cash.

NAV per Barrel Calcs

Turkmen Oil

Reserves	283 mb	Brent	70 \$/bbl	Royalties	0% of sales	Discount	8%											
Acquisition cost	9.3 \$/bbl	Discount	4%	Interest	5% of debt	NPV	3425.5											
Development capex	19.0 \$ per bbl	Production	10 \$/bbl	Tax Allow	20% of capex	NPV/CX	120%											
Maint	of capex	Gearing	0% ceiling	Tax	25% of Profit	IRR	25.5%											
Reserve Life at Purchase	24 years	Loan	0 years															
Peak	66 kbd																	
Gearing	0																	
Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	
2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
Acqn	-2632																	
Dev at \$11/bbl	-220																	
Capex	-2852	-227.5	-242.6	-266.6	-306.6	-337.3	-371.0	-408.1	-408.1	-408.1	-367.3	-330.6	-297.5	-267.8	-241.0	-216.9	-195.2	
Cumul funds ex Int + Tax	-2852	-2397.0	-1728.5	-993.8	-148.8	780.6	1803.1	2927.7	4052.4	5177.0	6189.2	7100.2	7920.0	8657.9	9322.0	9919.7	10457.6	
Production Profile	0																	
Prod kbd	0	32.8	39.3	43.2	49.7	54.6	60.1	66.1	66.1	66.1	59.5	53.6	48.2	43.4	39.0	35.1	31.6	
Prod bpa	0	12.0	12.8	14.0	16.1	17.8	19.5	21.5	21.5	21.5	19.3	17.4	15.7	14.1	12.7	11.4	10.3	
			14.3	15.8	18.1	19.9	21.9	24.1	24.1	24.1	21.7	19.5	17.6	15.8	14.3	12.8	11.5	
Brent	0	70	85	85	85	85	85	85	85	85	85	85	85	85	85	85	85	
Avg Realisation	0	67	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	
Revenues	0	802.1	1038.7	1141.7	1313.0	1444.3	1588.7	1747.6	1747.6	1747.6	1572.8	1415.5	1274.0	1146.6	1031.9	928.7	835.9	
Production	0	-119.7	-127.7	-140.3	-161.4	-177.5	-195.3	-214.8	-214.8	-214.8	-193.3	-174.0	-156.6	-140.9	-126.8	-114.2	-102.7	
Royalties	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Pre-tax Cash	0	682.4	911.0	1001.4	1151.6	1266.8	1393.4	1532.8	1532.8	1532.8	1379.5	1241.6	1117.4	1005.7	905.1	814.6	733.1	
Non Cash	0	-111.3	-76.6	-84.2	-96.8	-106.5	-117.2	-128.9	-128.9	-128.9	-116.0	-104.4	-94.0	-84.6	-76.1	-68.5	-61.6	
Interest Charge		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Pre-Tax Profit	0	571.1	834.4	917.2	1054.8	1160.2	1276.3	1403.9	1403.9	1403.9	1263.5	1137.2	1023.4	921.1	829.0	746.1	671.5	
Tax Charge	0	-142.8	-208.6	-229.3	-263.7	-290.1	-319.1	-351.0	-351.0	-351.0	-315.9	-284.3	-255.9	-230.3	-207.2	-186.5	-167.9	
Net Tax Allowances	570.4	45.5	48.5	53.3	61.3	67.5	74.2	81.6	81.6	81.6	73.5	66.1	59.5	53.6	48.2	43.4	39.0	
Tax Payment		570.4	-97.3	-160.1	-176.0	-202.4	-222.6	-244.9	-269.3	-269.3	-269.3	-242.4	-218.2	-196.4	-176.7	-159.0	-143.1	
Post Tax Cash	-2852	1025.3	571.2	574.7	669.0	727.1	799.8	879.8	855.3	855.3	742.8	668.6	601.7	541.5	487.4	438.6	394.8	

■ Dragon is worth more as a stand alone company

If minority shareholders recognise the level of value being ceded to ENOC at such excess levels of implied IRR, they will look instead at the long term value of Dragon's cash flows as an independent.

On this basis, the applicable discount factor becomes the risk-adjusted cost of capital rather than the hurdle rate required by (and conceded to) the acquiring company. This reduces the discount rate to 12% (reflecting an additional risk for Turkmenistan assets and crude flows through Iran) rather 20%.

Note that 12% is equal to the discount rate we use to assess Tullow Oil's risked reserves in Uganda, which we see as of similar political and greater technical risk than the existing, producing assets of Dragon Oil in Turkmenistan

Note also that there is no change in any other assumptions used in our valuation methodology, eg oil price, expected reserves, etc

In this basis, we estimate the stand-alone value of Dragon Oil at 805p, based on an average NAV per barrel of \$9.70 of 2P reserves and \$5.37 per barrel including contingent gas reserves.



Reserves	283 mb	Brent	70 \$/bbl	Royalties	0% of sales	Discount	8%									
Acquisition cost	18.8 \$bbl	Discount	4%	Interest	5% of debt	NPV	1259.3									
Development capex	19.0 \$ per bbl	Productior	10 \$/bbl	Tax Allow	20% of capex	NPV/CX	23%									
Maint	of capex	Gearing	0% ceiling	Tax	25% of Profit	IRR	12.0%									
Reserve Life at Purchase	24 years	Loan	0 years													
Peak	66 kbd															
Gearing	0															
Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Acqn	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Dev at \$11/bbl	-5320															
Capex	-220															
Cumul funds ex Int + Tax	-5540	-227.5	-242.6	-266.6	-306.6	-337.3	-371.0	-408.1	-408.1	-408.1	-367.3	-330.6	-297.5	-267.8	-241.0	-216.9
Production Profile	0															
Prod kbd	0	32.8	39.3	43.2	49.7	54.6	60.1	66.1	66.1	66.1	59.5	53.6	48.2	43.4	39.0	35.1
Prod bpa	0	12.0	12.8	14.0	16.1	17.8	19.5	21.5	21.5	21.5	19.3	17.4	15.7	14.1	12.7	11.4
			14.3	15.8	18.1	19.9	21.9	24.1	24.1	24.1	21.7	19.5	17.6	15.8	14.3	12.8
Brent	0	70	85	85	85	85	85	85	85	85	85	85	85	85	85	85
Avg Realisation	0	67	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571	81.3571
Revenues	0	802.1	1038.7	1141.7	1313.0	1444.3	1588.7	1747.6	1747.6	1747.6	1572.8	1415.5	1274.0	1146.6	1031.9	928.7
Production	0	-119.7	-127.7	-140.3	-161.4	-177.5	-195.3	-214.8	-214.8	-214.8	-193.3	-174.0	-156.6	-140.9	-126.8	-114.2
Royalties	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax Cash	0	682.4	911.0	1001.4	1151.6	1266.8	1393.4	1532.8	1532.8	1532.8	1379.5	1241.6	1117.4	1005.7	905.1	814.6
Non Cash	0	-225.1	-76.6	-84.2	-96.8	-106.5	-117.2	-128.9	-128.9	-128.9	-116.0	-104.4	-94.0	-84.6	-76.1	-68.5
Interest Charge		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-Tax Profit	0	457.3	834.4	917.2	1054.8	1160.2	1276.3	1403.9	1403.9	1403.9	1263.5	1137.2	1023.4	921.1	829.0	746.1
Tax Charge	0	-114.3	-208.6	-229.3	-263.7	-290.1	-319.1	-351.0	-351.0	-351.0	-315.9	-284.3	-255.9	-230.3	-207.2	-186.5
Net Tax Allowances	1108.1	45.5	48.5	53.3	61.3	67.5	74.2	81.6	81.6	81.6	73.5	66.1	59.5	53.6	48.2	43.4
Tax Payment		1108.1	-68.8	-160.1	-176.0	-202.4	-222.6	-244.9	-269.3	-269.3	-269.3	-242.4	-218.2	-196.4	-176.7	-159.0
Post Tax Cash	-5540	1563.0	599.6	574.7	669.0	727.1	799.8	879.8	855.3	855.3	742.8	668.6	601.7	541.5	487.4	438.6

2P Oil Reserves	296
Contingent Gas Reserves	222.7
Total Reserves	518.7
Oil \$/bbl	18.80
Gas \$/boe	4.10
Value of Reserves \$/boe	597.5
Cash \$m	87.5
Term Deposits	0.0
Fair Value including Net Debt	\$m 685.0
Long term \$/£	1.65
Market Cap	£m 415.1
Shares out	515.0
Implied Price	pence 806

2P Oil Reserves	Million bbl	296
Market Cap	£m	2343.3
\$/£		1.64
Market Cap	\$m	3842.9
Net Debt	\$m	-962.0
EV	\$m	2880.9
EV per Barrel		9.73

2P Oil Reserves	Million bbl	296
Risked Gas Reserves	Million boe	222.7
Risked Reserves	Million boe	518.7
Market Cap	£m	2343.3
\$/£		1.60
Market Cap	\$m	3749.2
Net Debt	\$m	-962.0
EV	\$m	2787.2
EV per Barrel		5.37

Scenario Analysis

■ More than 12.2% of shareholders reject the ENOC bid: stand-alone value

Ignoring the potential that ENOC has allowed itself to sweeten the bid (which we see as only marginal in practice), in the event of the bid not achieving the necessary votes from minority shareholders we would expect to see Dragon to fall below the 455p offer price but only for a relatively brief period, and the extent of the downside weaker than we estimated before ENOC went ahead with the offer. This is because we believe the intrinsic value of Dragon's cash flows will remain a key attraction for investors.

While we recognise that there will always be a significant number of shareholders who will be comfortable to realise lower gains for cash in the near term, we believe that the balance between cash up front versus sacrifice of value is too weighted in favour of ENOC and will be rejected by a sufficient quorum of shareholders – and given the higher NPV of Dragon's reserves as an independent, we strongly recommend independent investors not to accept the offer.

Note that ENOC does not bring operational, management or financial synergies to Dragon Oil, which would be lost in the event of failure of the bid. In fact, all the ENOC bid brings is a transfer of underlying value to the acquirer in return for cash in the near term. ENOC is strongly believed to have come close to making bids on two previous occasions, yet failure to execute has hardly condemned Dragon Oil's share price to years in the doldrums

■ More than 12.2% of shareholders reject the ENOC bid: alternative bid potential

We believe that failure to execute the deal may enforce a change in attitude to Dragon on the part of ENOC and the Dubai government.

At the present level, acquiring Dragon clearly represents a significant opportunity, in which ENOC can access \$1bn almost immediately and then significantly attractive cash flows thereafter, for a cash outlay of only \$1.9bn. Such is the balance in favour of ENOC that we believe those providing funds to the government of Dubai will see this as a sensible commercial opportunity, despite the strong calls on cash elsewhere in the emirate to support companies showing greater signs of distress.

However, we see that such attitudes may change if this easy opportunity does not become reality, and instead lenders may look to Dubai also to contribute to its own recovery by realising fungible assets where they can. Dragon's cash and reserves represent an attractive long term strategic asset for ENOC, but also a fungible asset for the government of Dubai.

Since initiation in December 2008, we have argued that if Dubai really want to manage its cash it has three options, of increasing value:

- 1) initiate dividend payments from Dragon oil
- 2) exploit controlling stake to buy out minorities to access cash and long term cashflows
- 3) realise greater immediate cash by selling its stake to a strategic investor, removing the discount from its own blocking share

We are presently at stage 2). If this is blocked, we continue to see stage 3) as an option. While we do not expect any competing bid directly against ENOC (as to do so would effectively pitch any company trying to buy it against the ruling family of a gulf state – not normally a sensible strategy), this would no longer be the case if the ENOC bid was blocked. In this event, an approach could be portrayed as supportive rather than hostile, helping Dubai to realise cash to support its near term requirements. We see no shortage of interest in access to producing assets in central asia, especially given the emphasis on accessing reserves in both oil and gas capable of moving west, north or east.

On this basis, we believe an offer based mid-way between ENOC's 455p and the long term NAV of 805p is very plausible, providing an alternative acquirer with returns above the 15% used to assess acquisitions by western companies (and above those sought by Chinese companies) and providing Dubai with cash

■ **Vote against but deal agreed anyway: Downside risk at 455p**

There is no restriction on minority shareholders who vote against the offer from selling at the agreed price if it does indeed go through. In such an event, the downside risk is minimal.

Investment conclusion

We strongly recommend independent investors NOT TO ACCEPT THE OFFER from ENOC, which we estimate at a 40% discount of the value of Dragon's independent cash flows. Given that ENOC have failed to come forward with a realistic bid based on a 20% IRR, we look at what Dragon is worth independently, and we are raising our target price to 805p, a significant uplift which highlights the real attraction of Dragon's assets

Peer Group Valuation

Company	Country	Rec.	Price	Target Price	Market cap EUR (m)	P/E(adj.)		Div. Yield %		EV/EBITDA	
			2-Nov-09	Fair value		2009	2010	2009	2010	2009	2010
BIOPETROL Industries	DE	Hold	EUR 1.24	0.60	63	nm	41.3	0.0	0.0	nm	11.5
BP	GB	Accumulate	GBP 584.70	650.00	120,957	12.8	9.6	5.8	6.0	5.9	5.0
Cepsa	ES	Accumulate	EUR 24.04	33.00	6,432	21.5	15.3	3.5	3.7	6.6	5.6
Dragon Oil	GB	Buy	GBP 446.50	805.00	2,545	14.8	9.8	0.0	0.0	5.2	3.3
Eni	IT	Hold	EUR 17.15	18.00	68,692	11.2	10.2	6.7	7.0	3.7	3.5
EOP Biodiesel	DE	Hold	EUR 0.77	1.00	4	nm	3.1	0.0	0.0	9.2	5.0
Galp Energia	PT	Buy	EUR 11.79	15.00	9,770	39.7	24.9	2.0	1.7	19.8	13.5
Hellenic Petroleum	GR	Hold	EUR 8.07	8.00	2,466	11.5	12.4	5.6	5.6	8.9	7.7
Maurel Et Prom	FR	Buy	EUR 13.98	17.00	1,694	7.8	7.3	4.2	4.6	2.6	4.5
Motor Oil	GR	Buy	EUR 11.94	13.00	1,323	11.4	10.7	9.2	8.4	8.6	8.1
Neste Oil	FI	Accumulate	EUR 12.10	13.00	3,102	38.1	18.2	1.2	3.0	11.7	9.5
Repsol Ypf	ES	Hold	EUR 18.44	21.40	22,506	12.8	9.9	4.9	5.4	5.2	4.3
Royal Dutch Shell (UK)	GB	Accumulate	GBP 1770.50	1960.00	123,801	13.6	9.6	5.6	5.8	5.7	4.5
Statoil	NO	Hold	NOK 137.50	145.00	51,726	18.5	9.0	3.3	5.5	3.2	2.6
Total	FR	Buy	EUR 41.15	52.00	92,452	14.3	9.3	5.6	5.6	5.7	4.2
Tullow Oil plc	GB	Accumulate	GBP 1188.00	1400.00	10,538	nm	nm	0.2	0.2	26.4	23.5
Tupras	TR	Buy	TRY 26.00	27.00	2,932	12.8	7.8	7.5	12.2	7.7	5.5
Mkt cap total (EUR) & Weighted averages					521,004	13.9	9.9	5.3	5.7	5.1	4.2
Arithmetical Average						17.0	12.8	3.9	4.5	8.3	7.0
Median						13.6	9.9	4.6	5.5	5.9	5.0

Source: ESN estimates

Dragon Oil: Summary tables

PROFIT & LOSS (USDm)	2006	2007	2008	2009e	2010e	2011e
Sales	325	597	706	617	862	1,142
Cost of Sales & Operating Costs (excl. Pers. Expenses)	-30.1	-86.1	-84.7	-67.4	-96.3	-178
Personnel Expenses	-12.2	-19.2	-22.1	-25.4	-29.2	-33.6
Non Recurrent Expenses/Income	0.0	-24.3	24.3	0.0	0.0	0.0
EBITDA	283	467	624	524	736	931
EBITDA (adj.)*	283	491	599	524	736	931
D & A						
EBIT	221	365	474	306	485	644
EBIT (adj.)*	221	389	450	306	485	644
Net Financial Interest	12.0	19.2	25.1	32.4	28.8	34.6
Other Financials	0.0	0.0	0.0	0.0	0.0	0.0
Associates						
Other Non Recurrent Items						
Earnings Before Tax (EBT)	233	384	499	339	514	678
Tax	-46.4	-80.3	-130	-84.7	-128	-170
<i>Tax rate</i>	<i>19.9%</i>	<i>20.9%</i>	<i>26.1%</i>	<i>25.0%</i>	<i>25.0%</i>	<i>25.0%</i>
Discontinued Operations						
Minorities						
Net Profit (reported)	187	304	369	254	385	509
Net Profit (adj.)	187	304	369	254	385	509
CASH FLOW (USDm)	2006	2007	2008	2009e	2010e	2011e
Cash Flow from Operations before change in NWC	270	531	568	527	730	922
Change in Net Working Capital	-41.5	-24.0	96.2	-38.1	-3.4	-3.8
Cash Flow from Operations	228	507	664	489	727	918
Capex	-156	-236	-288	-200	-350	-350
Net Financial Investments	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow	72.1	271	376	289	377	568
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Other (incl. Capital Increase & share buy backs)						
Change in Net Debt						
NOPLAT	177	308	333	230	364	483
BALANCE SHEET & OTHER ITEMS (USDm)	2006	2007	2008	2009e	2010e	2011e
Net Tangible Assets	513	639	777	759	858	921
Net Intangible Assets (incl. Goodwill)	0.0	0.8	0.9	0.9	0.9	0.9
Net Financial Assets & Other	0.0	0.0	0.0	0.0	0.0	0.0
Total Fixed Assets	513	640	777	760	859	922
Net Working Capital	41.3	24.1	-29.7	8.4	11.8	15.6
Shareholders Equity	754	1,060	1,442	1,660	2,004	2,465
Minorities Equity	0.0	0.0	0.0	0.0	0.0	0.0
Net Debt	-296	-549	-876	-1,035	-1,327	-1,767
Provisions	96.1	147	181	136	180	221
Other Net Liabilities or Assets						
Net Capital Employed/Invested	554	664	748	769	871	938
GROWTH & MARGINS	2006	2007	2008	2009e	2010e	2011e
<i>Sales growth</i>	<i>30.7%</i>	<i>83.5%</i>	<i>18.4%</i>	<i>-12.7%</i>	<i>39.7%</i>	<i>32.5%</i>
<i>EBITDA growth</i>	<i>36.9%</i>	<i>65.1%</i>	<i>33.5%</i>	<i>-16.0%</i>	<i>40.5%</i>	<i>26.4%</i>
<i>EBITDA (adj.)* growth</i>	<i>36.9%</i>	<i>73.7%</i>	<i>22.0%</i>	<i>-12.6%</i>	<i>40.5%</i>	<i>26.4%</i>
<i>EBIT growth</i>	<i>35.9%</i>	<i>65.0%</i>	<i>29.8%</i>	<i>-35.4%</i>	<i>58.2%</i>	<i>32.8%</i>
<i>EBIT (adj)*growth</i>	<i>35.9%</i>	<i>75.9%</i>	<i>15.5%</i>	<i>-31.9%</i>	<i>58.2%</i>	<i>32.8%</i>
<i>Net Profit growth</i>	<i>75.6%</i>	<i>62.6%</i>	<i>21.4%</i>	<i>-31.1%</i>	<i>51.6%</i>	<i>32.1%</i>
<i>EPS adj. growth</i>	<i>62.5%</i>	<i>62.3%</i>	<i>20.8%</i>	<i>-31.1%</i>	<i>51.6%</i>	<i>32.1%</i>
<i>DPS adj. growth</i>						
<i>EBITDA margin</i>	<i>87.0%</i>	<i>78.3%</i>	<i>88.3%</i>	<i>84.9%</i>	<i>85.4%</i>	<i>81.5%</i>
<i>EBITDA (adj)* margin</i>	<i>87.0%</i>	<i>82.3%</i>	<i>84.9%</i>	<i>84.9%</i>	<i>85.4%</i>	<i>81.5%</i>
<i>EBIT margin</i>	<i>68.1%</i>	<i>61.2%</i>	<i>67.1%</i>	<i>49.7%</i>	<i>56.3%</i>	<i>56.4%</i>
<i>EBIT (adj)* margin</i>	<i>68.1%</i>	<i>65.3%</i>	<i>63.7%</i>	<i>49.7%</i>	<i>56.3%</i>	<i>56.4%</i>

Dragon Oil: Summary tables

RATIOS	2006	2007	2008	2009e	2010e	2011e
Net Debt/Equity	-0.4	-0.5	-0.6	-0.6	-0.7	-0.7
Net Debt/EBITDA	-1.0	-1.2	-1.4	-2.0	-1.8	-1.9
Interest cover (EBITDA/Fin.interest)	nm	nm	nm	nm	nm	nm
Capex/D&A						
Capex/Sales	47.9%	39.6%	40.8%	32.4%	40.6%	30.7%
NWC/Sales	12.7%	4.0%	-4.2%	1.4%	1.4%	1.4%
ROE (average)	28.4%	33.5%	29.5%	16.4%	21.0%	22.8%
ROCE (adj.)	32.0%	46.4%	44.5%	29.9%	41.8%	51.5%
WACC	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROCE (adj.)/WACC	nm	nm	nm	nm	nm	nm

PER SHARE DATA (USD)***	2006	2007	2008	2009e	2010e	2011e
Diluted number of shares	512.1	512.9	515.6	515.6	515.6	515.6
EPS (reported)	0.36	0.59	0.72	0.49	0.75	0.99
EPS (adj.)	0.36	0.59	0.72	0.49	0.75	0.99
BV/PS	1.47	2.07	2.80	3.22	3.89	4.78
DPS	0.00	0.00	0.00	0.00	0.00	0.00

VALUATION	2006	2007	2008	2009e	2010e	2011e
EV/Sales	4.4	5.0	0.4	4.4	2.8	1.8
EV/EBITDA	5.1	6.4	0.5	5.2	3.3	2.2
EV/EBITDA (adj.)*	5.1	6.1	0.5	5.2	3.3	2.2
EV/EBIT	6.5	8.2	0.6	8.9	5.0	3.1
EV/EBIT (adj.)*	6.5	7.7	0.7	8.9	5.0	3.1
P/E (adj.)	9.3	11.6	3.2	14.8	9.8	7.4
P/BV	2.3	3.3	0.8	2.3	1.9	1.5
Total Yield Ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EV/CE	2.6	4.5	0.4	3.6	2.8	2.1
OpFCF yield	12.0%	13.8%	54.4%	12.4%	18.7%	23.8%
OpFCF/EV	14.5%	16.4%	209.9%	17.2%	28.9%	44.8%
Payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Dividend yield (gross)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

EV AND MKT CAP (USDm)	2006	2007	2008	2009e	2010e	2011e
Price (GBP) **	207	420	140	447	447	447
Outstanding number of shares for main stock	512	513	516	516	516	516
Total Market Cap	1,735	3,528	1,182	3,770	3,770	3,770
Net Debt	-296	-549	-876	-1,035	-1,327	-1,767
o/w Cash & Marketable Securities	2,960	2,590	3,562	9,595	9,954	9,954
o/w Short Term Debt	0.0	0.0	0.0	0.0	0.0	0.0
o/w Long Term Debt	0.0	0.0	0.0	0.0	0.0	0.0
Other EV components	0.0	0.0	0.0	0.0	0.0	0.0
Enterprise Value (EV adj.)	1,439	2,979	307	2,735	2,443	2,003

Source: Company, NCB Stockbrokers estimates.

Notes

* Where EBITDA (adj.) or EBIT (adj.) = EBITDA (or EBIT) +/- Non Recurrent Expenses/Income

** Price (in local currency): Fiscal year end price for Historical Years and Current Price for current and forecasted years

*** EPS (adj.) diluted = Net Profit (adj.) / Avg DIL. Ord. (+ Ord. equivalent) Shs. EPS (reported) = Net Profit reported / Avg DIL. Ord. (+ Ord. equivalent) Shs.

Company Description:

Dragon Oil is an Oil and Gas Producer with producing assets in Turkmenistan, owned 52% by Emirates National Oil Company. It is expanding oil production and in the process of developing gas for commercial sale which will allow the company to upgrade reserves

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The ESN Recommendation System is **Absolute**. It means that each stock is rated on the basis of a **total return**, measured by the upside potential (including dividends and capital reimbursement) over a **12 month time horizon**.

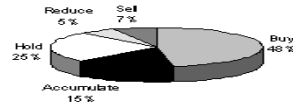
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Furthermore, in specific cases and for a limited period of time, the analysts are allowed to rate the stocks as **Rating Suspended (RS)** or **Not Rated (NR)**, as explained below.

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NCB Stockbrokers Ratings Breakdown

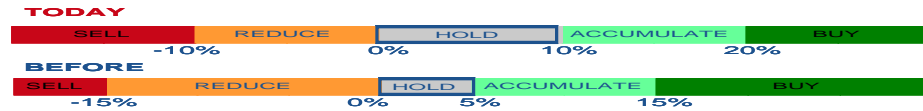


History of ESN Recommendation System

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Since **4 August 2008**, the ESN Rec. System has been amended as follow.

- Time horizon changed from 6 months to 12 months
- Recommendations Total Return Range changed as below:

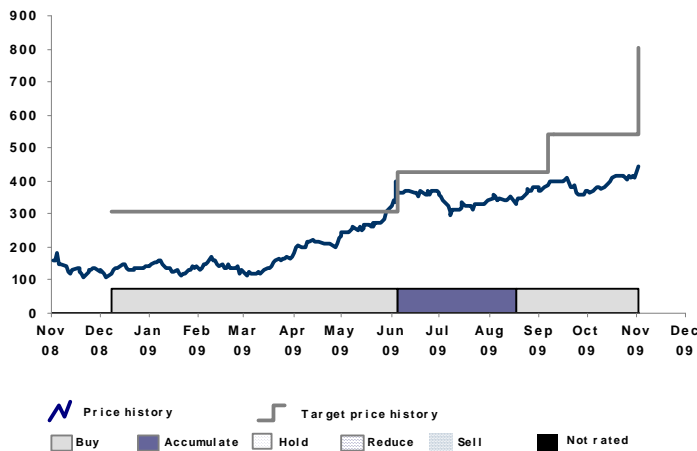


Recommendation history for DRAGON OIL

Date	Recommendation	Target price	Price at change date
02-Nov-09	Buy	805.00	446.50
07-Sep-09	Buy	540.00	387.75
17-Aug-09	Buy	435.00	331.00
05-Jun-09	Accumulate	435.00	375.00
09-Dec-08	Buy	340.00	135.00

Source: Factset & ESN, price data adjusted for stock splits.

This chart shows NCB Stockbrokers continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. Current analyst: Peter Hutton (since 02/12/2008)



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RESEARCH

Investment Strategy	Bernard McAlinden	bernard.mcalinden@ncb.ie	353 1 611 5933
Economic Research	Brian Devine	brian.devine@ncb.ie	353 1 611 5847
Airlines	Neil Glynn	neil.glynn@ncb.ie	353 1 611 5854
Banks	Ciaran Callaghan	ciaran.callaghan@ncb.ie	353 1 611 5876
	Simon Willis	simon.willis@ncb.ie	44 207 071 5217
	Irfan Younus	irfan.younus@ncb.ie	44 207 071 5236
Construction & Mid Caps	Tommy Conway	tommy.conway@ncb.ie	353 1 611 5842
	Conor Harnett	conor.harnett@ncb.ie	353 1 611 5917
	Ciaran Callaghan	ciaran.callaghan@ncb.ie	353 1 611 5876
Food & Beverages	Paul Meade	paul.meade@ncb.ie	353 1 611 5927
Gaming	Neil Glynn	neil.glynn@ncb.ie	353 1 611 5854
Oil & Gas	Peter Hutton	peter.hutton@ncb.ie	44 207 071 5227
Pharmaceuticals	Tommy Conway	tommy.conway@ncb.ie	353 1 611 5842
	Conor Harnett	conor.harnett@ncb.ie	353 1 611 5917
Shipping	Amrit Singh	amrit.singh@ncb.ie	44 207 334 5427
Support	Anezka Pavelkova	anezka.pavelkova@ncb.ie	44 207 071 5212
ESN Database	Lucia Raccone	lucia.raccone@ncb.ie	353 1 611 5924
	Carolien Hoefman	carolien.hoefman@ncb.ie	353 1 611 5928

SALES & TRADING

SALES				SALES TRADING			
Tommy Conway	353 1 611 5842	tommy.conway@ncb.ie		Paul Chew	paul.chew@ncb.ie		353 1 611 5826
Jonathan Cooke	44 207 071 5210	jonathan.cooke@ncb.ie		Alan Duff	alan.duff@ncb.ie		353 1 611 5835
Catherine Flavin	353 1 611 5816	catherine.flavin@ncb.ie		Nick Howells	nick.howells@ncb.ie		44 207 071 5219
Karl Goggin	353 1 611 5804	karl.goggin@ncb.ie		Cormac Mullen	cormac.mullen@ncb.ie		353 1 611 5840
Billy Hanley	353 1 611 5815	billy.hanley@ncb.ie		Cathal O'Leary	cathal.oleary@ncb.ie		353 1 611 5808
Murray McCarter	353 1 611 5827	murray.mccarter@ncb.ie		Gerry Walsh	gerry.walsh@ncb.ie		353 1 611 5813
Ed Murray	353 1 611 5839	ed.murray@ncb.ie					
Sandra Sala Vila	44 207 071 5214	sandra.salavila@ncb.ie					
Rod Salmon	44 207 071 5225	rod.salmon@ncb.ie					
John Sheehan	353 1 611 5912	john.sheehan@ncb.ie		TRADING			
Richard Walker	44 207 071 5220	richard.walker@ncb.ie		Clive Cleary	clive.cleary@ncb.ie		353 1 611 5811
				Mick Kilduff	micheal.kilduff@ncb.ie		353 1 611 5817
				Paul Lynch	paul.lynch@ncb.ie		353 1 611 5878
				Shane O'Kelly	shane.okelly@ncb.ie		353 1 611 5836

GENERAL SWITCH:

DUBLIN	353 1 611 5611	website: www.ncb.ie
LONDON	44 207 071 5200	email:forename.surname@ie
Bloomberg: ESNR <GO> for European Research		

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Members of ESN (European Securities Network LLP)

	 Banca Akros S.p.A. Viale Eginardo, 29 20149 Milano Italy Phone: +39 02 43 444 389 Fax: +39 02 43 444 302	   	Danske Markets Equities Holmens Kanal 2-12 DK-1092 Copenhagen K Denmark Phone: +45 45 12 00 00 Fax: +45 45 14 91 87
	 Bank Degroof Rue de l'Industrie 44 1040 Brussels Belgium Phone: +32 2 287 91 16 Fax: +32 2 231 09 04		 Equinet AG Gräfststraße 97 60487 Frankfurt am Main Germany Phone: +49 69 – 58997 – 410 Fax: +49 69 – 58997 – 299
	 Caixa-Banco de Investimento Rua Barata Salgueiro, 33-5 1269-050 Lisboa Portugal Phone: +351 21 389 68 00 Fax: +351 21 389 68 98		 Investment Bank of Greece 24B, Kifisias Avenue 151 25 Marousi Greece Phone: +30 210 81 73 000 Fax: +30 210 68 96 325
	 Caja Madrid Bolsa S.V.B. Serrano, 39 28001 Madrid Spain Phone: +34 91 436 7813 Fax: +34 91 577 3770		 NCB Stockbrokers Ltd. 3 George Dock, Dublin 1 Ireland Phone: +353 1 611 5611 Fax: +353 1 611 5781
	 CM - CIC Securities 6, avenue de Provence 75441 Paris Cedex 09 France Phone: +33 1 4016 2692 Fax: +33 1 4596 7788		NCB Stockbrokers UK Ltd. 51 Moorgate London EC2R 6BH United Kingdom
		 SNS Securities N.V. Nieuwezijds Voorburgwal 162 P.O.Box 235 1000 AE Amsterdam The Netherlands Phone: +31 20 550 8500 Fax: +31 20 626 8064	



European Securities Network LLP
Registered office c/o Withers LLP
16 Old Bailey - London EC4M 7EG