

MERISTEM EQUITY RESEARCH REPORT



REPORT DATE: FEBRUARY 16, 2007

RECOMMENDATION: **BUY/HOLD**

EXECUTIVE SUMMARY & INVESTMENT RATIONALE

- Eterna Oil and Gas Plc is a company operating in the down stream sector of the Nigerian petroleum industry along with industry heavy weights such as Conoil Plc, Mobil Oil Nigeria Plc, Oando Plc, Chevron (formerly Texaco) Nigeria Plc and Total Nigeria Plc
- The company was incorporated on January 13, 1989, commenced business in 1991 and was listed on The Nigerian Stock Exchange business August 3, 1998.
- Eterna Oil and Gas Plc manufactures and markets various lubricants and petrochemicals. The Company is also into importation and sale of petroleum products such as PMS, AGO, LPFO, Bitumen, LPG and provides engineering and technical services to its clients in the oil and gas industry.
- It is a wholly owned indigenous company with Eterna Marine & Services Ltd and Eterna Industries Ltd as its subsidiaries. The majority shareholder and core investor in the company is Lenux Integrated Resources Nigeria limited with 48.05% ownership of equity.
- The company's performance and fortunes nose-dived sharply in the late 1990s as a result of poor management and undercapitalization. The take over of the company by a new management team in 2005 and a fresh injection of fund changed the fortunes of the company from a loss profile of ₦229.67 million in 2005 to a Profit Before Tax of N38.25

million in the Q3-2006 results and also from a turnover of about ₦1.4b to a third quarter Turnover of ₦1.87billion.

- Eterna Oil is a franchisee to Castrol Subsea (U.S.A) with respect to the distribution of Castrol brand of lubricants in Nigeria and recently, it signed a Contract agreement with Castrol B.P which gives Eterna exclusive rights to manufacture and market Castrol's brand of marine lubricants in Nigeria and the West African sub region.
- The International Finance Corporation (IFC) recently made available a venture loan of US\$940,000 to Eterna Industries to fund the establishment of a 15,000 metric tons grease blending plant that will manufacture industrial, marine and automotive lubricants from products of Castrol Africa (Pty) Limited, a subsidiary of Castrol Plc in the UK.
- The company is expanding operations with the opening of 2 retail outlets in Abuja and 8 others by end of 2007 as well as strategic investments in private refineries and deregulated downstream petroleum products
- Eterna Oil and Gas Plc has just launched its products logo for a strong corporate identity. Furthermore, in order to strengthen its reporting standards especially with the increasing internationalization of its operations, the company changed its Auditors from Messrs Babington Ashaye & co to Messrs PriceWaterhouseCoopers (PWC). The company has also indicated its interest to raise fund from the capital market in order to finance its strategic expansion programme.
- We suggest a Buy/Hold recommendation on Eterna Oil & Gas Plc shares given its new management drive, its business growth opportunities as evidenced in significant turnover growth from fresh funds (though still inadequate to meet the finance needs of the company).
- Also, the shareholder's fund has improved from a negative position to a positive figure of N155million and projecting this into the future, we anticipate that the stock price will be trailing the big firms in the industry.

RECENT DEVELOPMENT AND TURNAROUND STRATEGIES:

In 2005, as part of its strategic move, the Board and Shareholders of Eterna Oil and Gas Plc issued by way of private placement 236million shares to Lenux Integrated Resources Nigeria Limited. This represented a US\$2.9million injection of much needed funds which boosted the company's working capital and reduced Eterna Oil and Gas Plc leverage and financial charges which were depressing the bottom line. The recent signing of a new contract between Castrol B.P. UK and Eterna Oil and Gas Plc has given the latter exclusive rights to manufacture and market Castrol range of Marine lubricants in Nigeria and the West African Sub region.

To make the company more competitive, Eterna Oil has embarked on a restructuring and repositioning exercise, which encompassed a high level of Corporate Governance, HSSE and Quality Standards, adoption of global best practices and has also been responsible for the company's improved financial performance which earned it the prestigious Pearls Award of excellence as the company with the highest turnover growth in 2005.

The company recently launched a new lubricant and re-branded old products alongside its new logo as part of re-branding exercise. The company intends to focus primarily in the deregulated market where there are competitive advantages in the marketing of products such as AGO, Bitumen, Liquefied Petroleum Gas (LPG), lubricants and base oil.

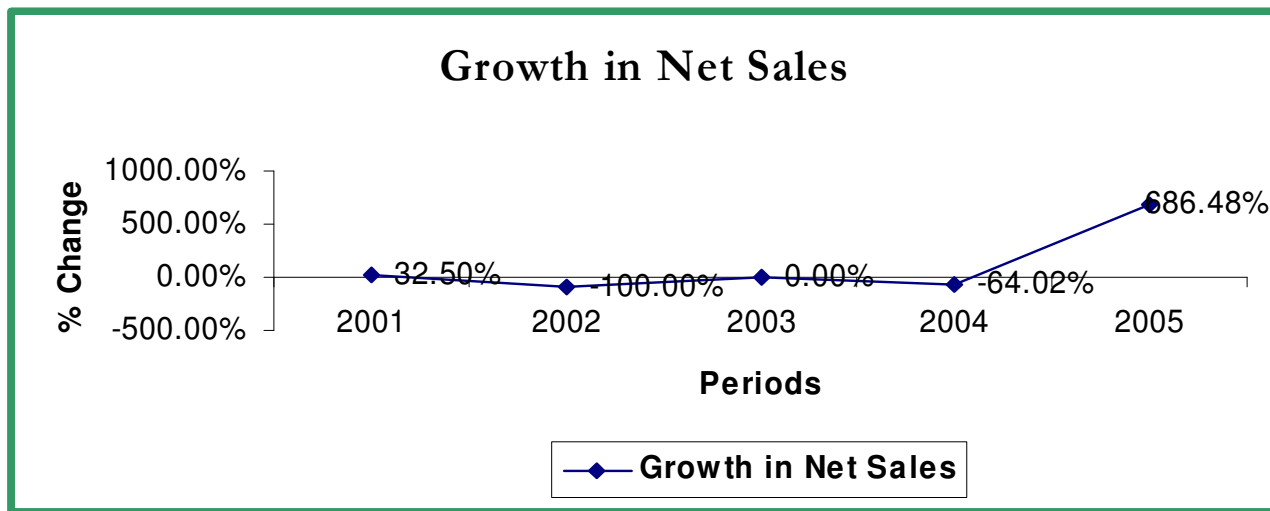
ANALYSIS OF FINANCIALS:

TURNOVER:

Eterna Oil's gross revenue declined from N1.248m in 2001 to N192,324 in 2004 before the 2005 strategic turnaround which breathed a new life into the company with a record of N1.45m revenue. This was further consolidated in 2006 as the company reported gross revenue of N2.023m in the third quarter.

In the same vein, operating profit margin, which measures how much is generated as income from N1 unit of sales, grew to 3.8% as at Q3-2006 from a loss margin of 63.9% in 2003. In

other words, Eterna transitioned from a 64k loss per N1 sales position in 2003 to a 4k profit per N1 sales in the third quarter of 2006.



LIQUIDITY:

Liquidity as the life wire of an organization most often, determines the growth of a company. A company with adequate working capital would be better positioned to ensure smooth operations. The dearths of adequate working capital stultify business growth and potential profitability.

Eterna Oil's 5-years financials performance gave a brief summary of inefficient management and undercapitalization as reflected in all phases of performance measurement until the new management came on board.

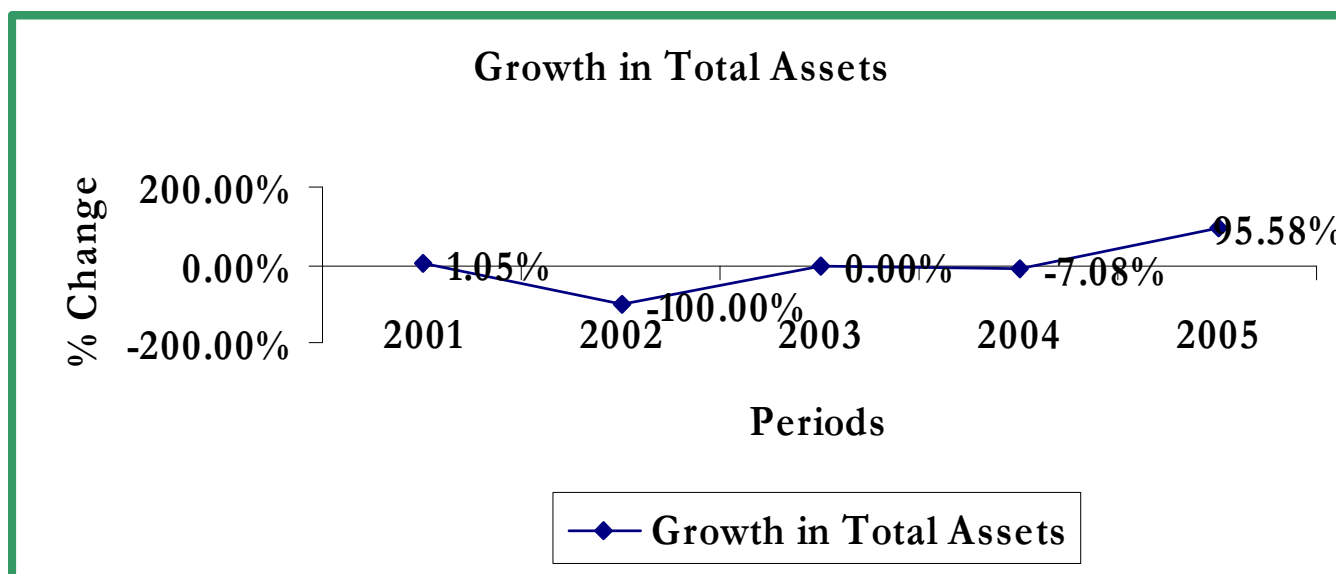
For the 5-year period under review (2001-2005), with the poor growing record of net current liabilities neither supported by inventory nor receivables, its net current liabilities stood at N554.99m in 2005 from N264.84m in 2003. However, following the injection of fresh funds in 2005 and 2006, the company heaved a sigh of relief as its working capital indices improved significantly.

The current ratio, which measures ability to pay short term obligations from its operating cash flows, improved from 0.4 times in 2005 to 0.81 times as at Q3-2006 (though this still falls below the theoretical benchmark of 2.0 times) . Moreover, quick ratio jumped from 0.11 times in 2005 to 0.63 times as at Q3-2006 (compared to benchmark of 1.0 times) while liquid ratio, an indication of the firm’s ability to pay off its current liabilities from cash if immediate payment were demanded for any reason, rose from 0.09 times in 2005 to 0.32 times as at Q3-2006. This is a commendable performance compared to the benchmark of 0.5 times.

CAPITAL ADEQUACY/GEARING:

The company’s balance sheet has significantly improved as at Q3-2006 compared to its status as at 2005 full year. Its shareholders’ funds currently stand at N154.94m against a negative balance of N124.16 m recorded in 2005.

As earlier mentioned, raising funds from the market or increasing the capital base of the company is a veritable option to actualize the company’s goals.



ETERNA OIL Q3-2006 PERFORMANCE:

Eterna Oil Plc has finally come out of woods as evidenced by its recently released third quarter results. The company recorded an organic growth in turnover by 175% from N68.01 m in Q3-2005 to N1.873bn in Q3-2006 while it transited from a loss profile of N49.761 m in Q3-2005 to a Profit Before Tax (PBT) status of N38.245 in Q3-2006. This gives a profit margin of 2.04%.

Eterna's interest burden stood at N32.97m in Q3-2006 compared to N44.51m paid in 2005 full year while its other incomes rose significantly from N32.94m in 2005 full year to N150 m as at Q3-2006. The decline in interest payment was due to newly injected funds from International Finance Corporation (IFC) and other sources part of which was used to defray outstanding overdraft facility. This has positively impacted on the company's gross incomes as reflected in the third quarter 2006 results.

STRATEGIC BUSINESS OUTLOOK:

Outlook for the company is very good as the deregulation of the downstream sector creates opportunities for growth. Similarly, the growth of the economy will provide a market for the company's lubricants as they will oil heavy machinery. The privatization of the power sector and increased maritime activity in the oil and Gas industry all infer good growth potentials for Eterna oil and Gas Plc.

As part of its strategic re-positioning, Eterna Oil recently acquired two retail outlets in Abuja and another one in Port Harcourt while others across the country are being upgraded as it plans to focus on market niche in retail business. The Lube Plant at Sagamu, Ogun State, has been upgraded to ensure products maintain their superior quality position in the industry.

The company is also making frantic effort to concentrate on storage facilities, starting with a 15, 000 metric tonnes storage facility in Lagos, and then, elsewhere as well as participate in strategic investments in private refineries. It is also on the march to acquire 30 strategically located retail outlets by end of 2007.

With a relative stable interest rate policy expected in 2007 and with inflation receding towards single digit figures, the company's costs are not in danger of external economic threats.

Moreover, the new management recently embarked on re-branding and re-launching of its products portfolio as a way of addressing the problem of lack of feasible corporate identity which has bedeviled the company for over a decade. Similarly, to rekindle investors hope and confidence in the company, management may likely pay dividends for the 2006 financial year, first in over 5 years.

Given all these notable strategic initiatives, it will not be out of context to conclude that the company requires fresh funds as it is currently warming up to approach the capital market in the near future to raise an additional fund to pilot its expansion initiatives and other future plans.

By and large, from a historical perspective, Eterna Oil's performances were marred by poor management and dearth of funds but given the new blend of technocrats in the management team, as evidenced by its modest achievements in the last twenty-four months, one could objectively argued that the company has what it takes to turn its fortunes around and establish it as a formidable player in the nation's oil and gas industry.

PEER GROUP PERFORMANCE ANALYSIS (2005YEAR-END)

Eterna Oil operates along with Conoil, Total, Mobil, Chevron etc in the downstream sector of the oil industry. Though the company is classified as operating in the downstream sector, classification by size and process may not adequately put it side by side with other companies in the sector. Therefore, relating its performance and values to others in the industry may not be appropriate as they are not co-equal.

However, the cost structure of the industry is very high and this is reflected in the individual company's performance within the industry.

Peeping into the activities of other companies within the industry, Oando Plc recorded the highest turnover of N182.76bn in the sector for 2005 while Total Nigeria Plc and Conoil Plc followed with N126.72bn and N75.53bn respectively. On the other hand, Total Nigeria Plc had

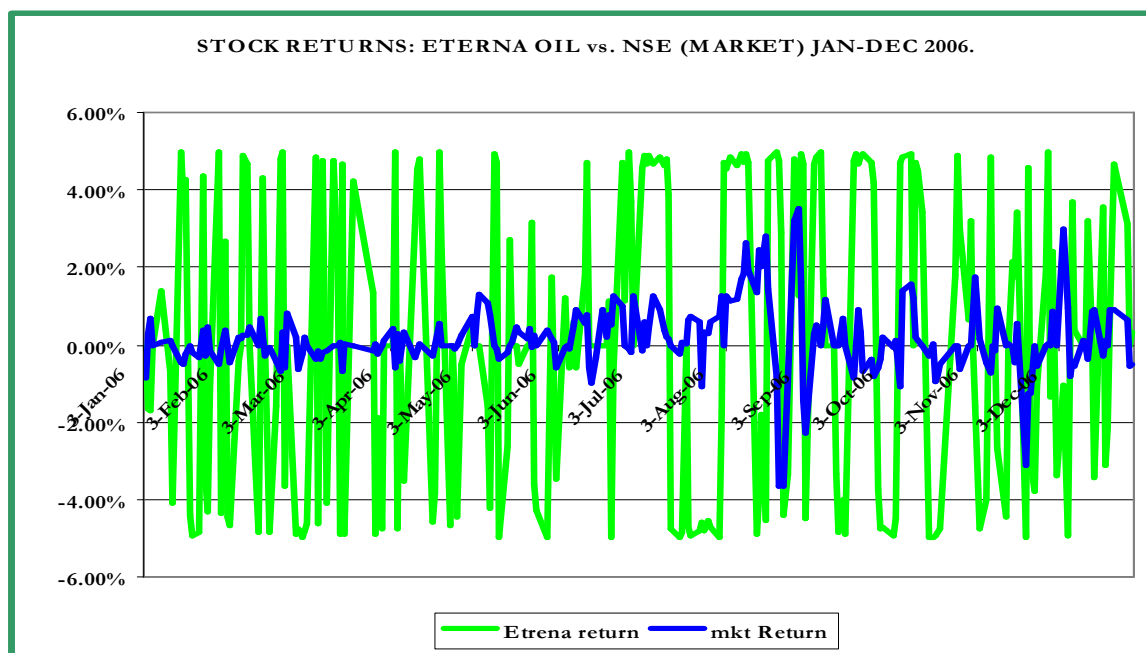
the highest Profit after Tax (PAT) of N3.615bn, followed by Conoil Plc with N2.624bn and Mobil Oil Nigeria Plc with N2.423bn.

Mobil Oil Nigeria Plc recorded the highest operating margin of 7.9%. This means that Mobil is the leader in terms of profitability. It was trailed by Conoil Nigeria Plc with 5.1% and Total Nigeria Plc with 3.6%. Oando Plc has the largest shareholders funds of N22.726bn while Conoil and Total have N8.486 bn and N4.132 billion respectively. Conoil, Oando and Eterna have the largest number of shares in issue with 693.95m, 572.30m and 500m respectively.

Similarly, Mobil recorded the highest return on assets (ROA) of 27.28%. Total recorded 18.08% while Chevron returned 12.49%. In the same vein, Total, Mobil and Chevron had the highest returns on shareholders' equity (ROE) with 87.49%, 73.30% and 33.57% in that order.

PEER QUARTERLY PERFORMANCE INDICATORS-Q3 2006

SYMBOL	MOBIL	TOTAL	CONOIL	CHEVRON	OANDO	AP	ETERNA OIL
PERIOD 2006	Q-3	Q-3	Q-3	Q-3	Q-3	Q-3	Q-3
TURNOVER (N'bn)	58.7	96.5	65.05	49.55	224.026	56.8	1.873
PBT (N'bn)	1.1	2.6	2.826	1.712	3.017	3.3	0.038
PAT (N'bn)	0.575	1.844	1.978	1.119	2.323	2.7	0.026
Profit Margin (%)	1.90%	2.68%	4.34%	3.46%	1.35%	5.81%	2.03%



PEER PERFORMANCE INDICES: PETROLEUM (MARKETING)

	Ind. Avrg	OANDO	CONOIL	CHEVRON (TEXACO)	MOBIL	TOTAL	ETERNA OIL	AP
		2005	2005		2005	2005	2005	2004
Turnover (N'bn)	78.20	182.764	75.535	51.942	50.914	126.722	1.417	58.11
PAT(N'bn)	1.73	1.77	2.62	1.05	2.42	3.62	-0.24	0.89
Shareholders' Funds((N'bn)	4.87	22.73	8.49	3.12	3.31	4.13	-0.12	-7.57
Shares Outstanding(million)	433.17	572.30	693.95	253.99	240.40	339.52	500.00	432.00
Sales Per Share	193.58	319.35	108.85	204.51	211.80	373.24	2.84	134.51
Book Value Per Share	10.34	39.71	12.23	12.26	13.75	12.17	-0.25	-17.52
Earning Per Share	4.47	2.65	3.78	4.12	10.08	10.65	0.00	0.00
Dividend Per Share	3.46	2.50	2.50	4.10	9.10	6.00	0.00	0.00
Mkt Price-February 14, 2007	109.57	78.91	77.00	166.95	189.6	180.50	8.5	65.5
Earnings Yield	3.61%	5.89%	5.73%	3.61%	5.09%	4.98%	0.00%	0.00%
Dividend Yield	2.70%	3.17%	3.25%	2.46%	4.80%	5.26%	0.00%	0.00%
Operating Margin	2.85%	2.51%	5.11%	3.16%	7.90%	3.59%	-7.35%	5.06%
OPEX/Sales	9.37%	7.51%	8.92%	6.75%	12.30%	9.05%	16.28%	4.74%
Gross Margin	11.17%	9.55%	14.31%	9.92%	16.55%	12.28%	6.61%	8.99%
Return On Assets (ROA)	7.61%	3.20%	13.33%	12.49%	27.28%	18.08%	-26.29%	5.15%
Return on Equity (ROE)	4.52%	7.80%	30.92%	33.57%	73.30%	87.49%	-189.71%	-11.76%
Price/Book Value	1.79	1.99	6.30	13.61	13.79	14.83	-34.23	-3.74
Price/Sales	0.95	0.25	0.71	0.82	0.90	0.48	3.00	0.49
P/E	14.55	16.98	17.45	27.68	19.64	20.08	0.00	0.00
Stock Volatility- β	0.75	0.85	1.24	0.69	0.84	0.83	0.32	0.47

RISK & CONCLUSION:

Risk associated with the company is basically the delay by the Federal Government to fully deregulate the sector as industry margin continues to wane. Also stiff competition from big players in the sector especially in the area of retail products also constitutes another challenge for Eterna Oil. The entry barrier into the industry is high due to capital requirements. The lack of adequate financial muscle to pursue highly profitable, capital intensive projects may also limit the company from actualizing its strategic objectives.

In conclusion, we recommend Eterna oil as a BUY/HOLD stock for medium and long term investors with a reasonable rate of return in not too distant future.

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