

## CAMAC Energy, Inc.

AMEX: CAK Industry: Oil & Gas

**Upgrading Rating & Reinstating Target  
Buy, \$4.00**

November 11, 2010

### MARKET DATA

Share Price:	2.55
Market Cap:	365.44 M
52wk Range:	2.11—6.07
Ave. Volume:	510,000
Basic S/O:	143.31 M
Diluted S/O:	165.30 M
Float:	48.06 M
Institutional %:	5%
Insider %:	66%

### FINANCIAL DATA (mrq)

Cash:	11.07 M
ST Debt:	0.00 M
LT Debt:	0.00 M
Book Value:	221.90 M
EBITDAS (ttm):	(3.99) M
CFFO (ttm):	2.40 M

**USD 2009A 2010e 2011e 2012e**

### Revenue (in Millions of USD)

Mar	0.00	0.08A	9.47	21.75
Jun	0.00	12.34A	9.47	38.67
Sep	0.06	8.82A	19.66	29.03
Dec	0.01	9.73	9.47	26.70
<b>REV</b>	<b>0.07</b>	<b>30.97</b>	<b>48.06</b>	<b>116.15</b>
<i>P/S</i>	<i>5,221</i>	<i>11.80</i>	<i>7.60</i>	<i>3.15</i>

### Diluted EPS

Mar	(0.07)	(0.07)A	(0.03)	0.01
Jun	(0.05)	(0.02)A	(0.03)	0.06
Sep	(0.06)	(1.32)A	(0.01)	0.05
Dec	(0.10)	(0.00)	(0.02)	0.03
<b>EPS</b>	<b>(0.28)</b>	<b>(1.54)</b>	<b>(0.08)</b>	<b>0.16</b>
<i>P/E</i>	<i>N/A</i>	<i>N/A</i>	<i>N/A</i>	<i>15.94</i>

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## Oyo Asset Impairment Recorded in Q3:10. CAMAC Shifts Focus From China to Western Africa.

### Key Updates

CAMAC recorded a \$186.24 million asset impairment after receiving an updated reserve report from Netherland, Sewell & Associates that showed gross 1P reserves of 20.24 million barrels and gross 2P reserves of 32.81 million barrels, down from gross 1P reserves of 25.56 million and 2P reserves of 50.20 million from their 2008 report. The impairment did not come as a surprise as it would have likely recorded an accounting impairment related to the rapid increase in its stock price between the time it announced the Oyo acquisition and the closing, which artificially increased the purchase price and value of Oyo.

CAMAC and ENI are in the process of fixing Well #5, which should start in December after the next lifting. The entire process is expected to take 30 to 45 days, including 15 days where the well will stop producing. The cost of the rework is expected to be \$45 million, which CAMAC will fund. We are currently expecting the Company to obtain debt financing as it will be able to recoup the funds as part of the Cost Oil operating expense recovery. Upon completion we expect production to increase to 12,000bopd.

The purchase of OML 120 and 121 is still expected to close by November 30, but we are not including any value from the asset, or milestone payments in our model at this time.

The current management team is focusing its efforts on becoming an E&P company with its primary assets in western Africa. As a result it is seeking to divest most of its Chinese assets, including its EORP business, Chifeng, and its option on the Handan gas distribution network. It is, however continuing its exploration work in Zijinshan where its second exploratory well is nearing completion and will be immediately followed by a third well. Production could start in 2012.

### Valuation

After making significant changes to our model and understanding the Company has devised a plan to fix Well #5, we are upgrading our rating on CAMAC Energy from Hold to Buy and reinstating a target price, which we are setting at \$4.00. We do note there is still a great deal of potential variance with our model as it assumes only operations at Oyo and Zijinshan, with no impact from OML 120 and 121. Our target price is based on an EV/EBITDAS multiple of 6 times our 2015 EBITDAS estimate of \$172.73 million using a 15% discount rate.

### Business Summary

CAMAC Energy, Inc. is an international oil and gas exploration and production company with investments in China and Nigeria. The Company, through its subsidiaries, has an interest in an offshore oilfield in Nigeria and coalbed methane/tight gas sand operations in China.

## COMPANY UPDATE

### Q3:10 Results [Oyo Impairment]

CAMAC reported \$8.82 million in Sales, inline with our estimate. Cost of Sales came in at \$6.08 million with \$2.73 million of SG&A, which included \$0.60 million of CEO search and related expenses. Most notably CAMAC recorded a \$186.24 million asset impairment after receiving an updated reserve report from Netherland, Sewell & Associates (NSAI) that showed gross 1P reserves of 20.24 million barrels and gross 2P reserves of 32.81 million barrels, down from gross 1P reserves of 25.56 million and 2P reserves of 50.20 million from their 2008 report. The decrease in reserves was the result of three factors: 1) roughly 2.6 million barrels has been extracted since the last report without being replaced by new wells, 2) a decrease in the oil recovery factor based on the problems experienced with the existing wells, and 3) the lower price of oil, from \$85 to \$75. The impairment did not come as a surprise as it would have likely recorded an accounting impairment related to the rapid increase in the Company's stock price between the time it announced the Oyo acquisition and the closing, which artificially increased the purchase price and value of Oyo. The resulting Net Loss for the quarter, excluding the impairment was \$2.32 million, or \$0.02 per share.

### Well #5 Update

Production at Oyo has fallen to 5,500bopd, due primarily to the excess natural gas leaking into the well and constricting oil production. After the next lifting, which is expected in December, CAMAC and ENI will find the source of the leak and apply a chemical sealant. The entire process is expected to take 30 to 45 days, including 15 days where the well will stop producing. The cost of the rework is expected to be \$45 million, which CAMAC will fund. We are currently expecting the Company to obtain debt financing as it will be able to recoup the funds as part of the Cost Oil operating expense recovery. Upon completion management expects the well to increase production by 5,000 to 8,000bopd, thereby increasing production in Oyo to 10,000 to 13,000bopd. Our model assumes a flow of 12,000bopd. At these levels there would be enough oil produced to have a lifting in Q1:11. We also note that Well #6 has seen an increase in water, but no action is expected as it produces oil at a much lower rate.

### OML 120/121 Update

Purchase of OML 120 and 121 is still expected to close by November 30, but we are not including any value from the asset, or milestone payments, until Well #5 is fixed in Oyo and two additional production wells are drilled. Management also reiterated that it will consider funding up to 30% of the capex for non-Oyo spending, which it would be able to recover with Cost Oil from the project.

### Revised Business Model

The current management team is focusing its efforts on becoming an E&P company with its primary assets in western Africa. To this end, the Company has put together a Business Development team that will explore M&A deals from both the CAMAC Energy Holdings portfolio and from other owners. Examples include the OML 120/121 acquisition and opportunities similar to the recent acquisition of Shell's interest in OML 26, which was purchased by Afren's Nigerian subsidiary in an all debt deal. CAMAC is hoping to take advantage of other asset sales in the region from Western-based companies to local Nigerian producers, like the Company's CAMAC Petroleum subsidiary.

### Chinese Asset Divestitures Looming

In conjunction with this strategy management is working to divest itself of its most of its Chinese opportunities. CAMAC is seeking to divest the EORP business as it is more of a service business and requires significant resources in China to secure contracts for different properties in need of the service. No assets have been devoted to Chifeng, which was still without a production license, and will be shut down. Similarly, the Company will abandon its option to acquire 49% of the Handan gas distribution network in China as it is outside CAMAC's model. Starting in Q4:10 we have removed all Chinese operations from our model with the exception of Zijinshan. By removing the EORP and Chifeng businesses from our model Revenue in 2011 declined by over \$14 million with no impact to Net Income and reduced 2012 Revenue and Net Income by \$52 million and \$8 million, respectively.

**COMPANY UPDATE****Zijinshan Update**

Despite the move from the other Chinese assets, the Zijinshan property still appears to be lucrative given the big players and level of production in the Ordos Basin. Drilling on the second exploratory well started in August and should be finished in the current quarter at which time drilling on the third well will commence. Management is expecting positive results from the wells, similar to those being found at properties surrounding Zijinshan. Additional exploratory drilling will be done in 2011, at which point the Company can determine whether it will produce the field or seek alternatives and raise cash. For modeling purposes, we are continuing to include Zijinshan given the real, near-term production potential; our model assumes production starts in the first quarter of 2012.

**Warrant Expiration**

2.0 million warrants exercisable at \$4.00 from the February 2010 financing expired on November 1. These shares, along with 3.37 million consideration shares that would have been owed to CAMAC Energy Holdings were removed from our model. The expiration also removed \$8.0 million in cash from our model. 1.66 million warrants priced at \$4.12 from the March 2010 financing are set to expire on December 5. If the warrants go unexercised, the 1.66 million shares underlying the warrants plus 2.79 million consideration shares that would have been due to CEH would be removed from the model. Failure to exercise would result in \$6.83 million in cash coming off our model.

## RISKS

### Commodity Prices

Much of the Company's profits are dependent on oil prices, which can be influenced by a vast array of variables, including global GDP growth, weather, actions of OPEC, government regulations, the availability and price of alternative fuels, global exploration and production, and oil inventories and demand.

### Nigerian Oil Attacks

Since 2005, Nigeria has experienced pipeline vandalism, kidnappings of oil workers, and militant takeovers of oil facilities in the Niger Delta, including Shell's Bonga Oilfield which is located near the Oyo Field. To date, there have been no attacks on the Oyo Field or any Allied holdings.

### Nigerian Petroleum Industry Bill

This proposed bill could increase regulations on the Nigerian O&G industry, as well as increase income taxes, which current vary between 50% and 85%. The Company believes the tax rate on the PSC will be 50%, plus a 2% education tax. Any increase in regulations or tax rate would have a significant negative impact on earnings.

### CAMAC International Influence

With 89.47 million shares, or 62.74% of the common stock, CAMAC International can exert influence over all aspects of the Company.

### Dilution from Consideration Shares

To allow CAMAC International to keep its 62.74% interest in CAMAC Energy, the Company agreed to grant CI with additional shares if its then outstanding options and warrants are exercised. If all 5.99 million options and warrants are exercised, the Company would be required to grant CI 10.10 million shares.

### Dependence on NAE

The Company is wholly dependent on NAE, the contractor for and 40% owner of OML 120, to cost effectively extract oil from the Oyo Field. CAMAC's income from Oyo could be adversely effected if NAE determine not to drill additional wells, has a shutdown of any kind, or experiences higher than expected operating costs.

### Zijinshan Development

The Company is still in the exploration phase in Zijinshan and may need to devote additional time and/or resources to bring the area to development stage.

## VALUATION

After making significant changes to our model and understanding the Company has devised a plan to fix Well #5, we are upgrading our rating on CAMAC Energy from Hold to Buy and reinstating a target price, which we are setting at \$4.00. We do note there is still a great deal of potential variance with our model as it assumes only operations at Oyo and Zijinshan, with no impact from OML 120 and 121. Our target price is based on an EV/EBITDAS multiple of 6 times our 2015 EBITDAS estimate of \$172.73 million using a 15% discount rate.

**ESTIMATED INCOME STATEMENT**

	Q1:10A	Q2:10A	Q3:10A	Q4:10e	2010e	Q1:11e	Q2:11e	Q3:11e	Q4:11e	2011e	2012e	2013e	2014e	2015e
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Price/bbl	70	70	75	75	75	75	75	75	75	75	80	85	85	85
Price/mcf	4.99	4.99	6.25	6.24	5.62	6.22	6.21	6.38	6.36	6.29	6.42	6.54	6.67	6.81
RMB:USD	6.83	6.83	6.81	6.83	6.82	6.84	6.86	6.88	6.90	6.87	6.94	7.01	7.08	7.15
<b>Total Revenue</b>	<b>77</b>	<b>12,343</b>	<b>8,820</b>	<b>9,725</b>	<b>30,965</b>	<b>9,467</b>	<b>9,467</b>	<b>19,660</b>	<b>9,467</b>	<b>48,061</b>	<b>116,150</b>	<b>149,197</b>	<b>186,671</b>	<b>235,895</b>
Cost of Sales	62	12,020	6,083	6,120	24,285	6,120	6,120	10,980	6,120	29,340	51,696	49,104	43,596	38,088
<b>Gross Profit</b>	<b>15</b>	<b>323</b>	<b>2,737</b>	<b>3,605</b>	<b>6,680</b>	<b>3,347</b>	<b>3,347</b>	<b>8,680</b>	<b>3,347</b>	<b>18,721</b>	<b>64,454</b>	<b>100,093</b>	<b>143,075</b>	<b>197,807</b>
Operating Expense/SG&A	2,022	1,891	2,734	1,888	8,535	1,962	2,014	2,069	2,126	8,171	8,944	9,808	10,007	10,211
Stock-based Comp	1,499	1,489	416	1,000	4,404	1,000	1,000	1,000	1,000	4,000	4,000	4,000	4,000	4,000
Business Tax	-	-	-	-	-	-	-	-	-	-	581	2,330	7,466	14,870
Depreciation	49	126	2,066	1,071	3,312	3,348	3,348	4,478	3,348	14,522	16,881	17,956	3,843	3,564
Asset Impairment	-	-	186,235	-	186,235	-	-	-	-	-	-	-	-	-
<b>Operating Income</b>	<b>(3,555)</b>	<b>(3,183)</b>	<b>(188,714)</b>	<b>(355)</b>	<b>(195,806)</b>	<b>(2,963)</b>	<b>(3,015)</b>	<b>1,133</b>	<b>(3,127)</b>	<b>(7,972)</b>	<b>34,047</b>	<b>65,999</b>	<b>117,760</b>	<b>165,162</b>
<b>EBITDAS</b>	<b>(2,007)</b>	<b>(1,568)</b>	<b>3</b>	<b>1,717</b>	<b>(1,855)</b>	<b>1,385</b>	<b>1,333</b>	<b>6,611</b>	<b>1,221</b>	<b>10,550</b>	<b>54,929</b>	<b>87,955</b>	<b>125,602</b>	<b>172,726</b>
Interest Income	4	2	1	25	32	(1,200)	(1,000)	(700)	(400)	(3,300)	150	250	400	400
Interest Expense	-	-	-	-	(3)	-	-	-	-	-	-	-	-	-
Other Income	-	-	(3)	-	(3)	-	-	-	-	-	-	-	-	-
Other Expense	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Income Before Taxes</b>	<b>(3,551)</b>	<b>(3,181)</b>	<b>(188,716)</b>	<b>(330)</b>	<b>(195,777)</b>	<b>(4,163)</b>	<b>(4,015)</b>	<b>433</b>	<b>(3,527)</b>	<b>(11,272)</b>	<b>34,197</b>	<b>66,249</b>	<b>118,160</b>	<b>165,562</b>
Income Tax Expense	(8)	(88)	83	(267)	(280)	(9)	(9)	(1,399)	(9)	(1,427)	(8,813)	(8,034)	(6,420)	(4,805)
<b>Income Before Min. Int.</b>	<b>(3,559)</b>	<b>(3,269)</b>	<b>(188,633)</b>	<b>(596)</b>	<b>(196,057)</b>	<b>(4,173)</b>	<b>(4,024)</b>	<b>(967)</b>	<b>(3,536)</b>	<b>(12,700)</b>	<b>25,384</b>	<b>58,215</b>	<b>111,740</b>	<b>160,757</b>
Minority Interest	148	97	76	-	321	-	-	-	-	-	-	-	-	-
<b>Net Income - GAAP</b>	<b>(3,411)</b>	<b>(3,172)</b>	<b>(188,557)</b>	<b>(596)</b>	<b>(195,736)</b>	<b>(4,173)</b>	<b>(4,024)</b>	<b>(967)</b>	<b>(3,536)</b>	<b>(12,700)</b>	<b>25,384</b>	<b>58,215</b>	<b>111,740</b>	<b>160,757</b>
<b>Basic EPS</b>	<b>(0.07)</b>	<b>(0.02)</b>	<b>(1.32)</b>	<b>(0.00)</b>	<b>(1.55)</b>	<b>(0.03)</b>	<b>(0.03)</b>	<b>(0.01)</b>	<b>(0.02)</b>	<b>(0.09)</b>	<b>0.17</b>	<b>0.38</b>	<b>0.70</b>	<b>1.01</b>
Basic S/O	46,844	135,760	143,313	148,161	126,548	148,176	148,191	148,206	148,220	148,198	148,932	153,901	158,874	159,674
<b>Diluted EPS</b>	<b>(0.07)</b>	<b>(0.02)</b>	<b>(1.32)</b>	<b>(0.00)</b>	<b>(1.54)</b>	<b>(0.03)</b>	<b>(0.03)</b>	<b>(0.01)</b>	<b>(0.02)</b>	<b>(0.08)</b>	<b>0.16</b>	<b>0.36</b>	<b>0.69</b>	<b>1.01</b>
Diluted S/O	46,844	135,760	143,313	148,161	126,883	148,176	148,191	160,684	161,072	154,531	161,501	161,788	161,732	159,674
<b>Gross Margin</b>	<b>20%</b>	<b>3%</b>	<b>31%</b>	<b>37%</b>	<b>22%</b>	<b>35%</b>	<b>35%</b>	<b>44%</b>	<b>35%</b>	<b>39%</b>	<b>55%</b>	<b>67%</b>	<b>77%</b>	<b>84%</b>
<b>Operating Margin</b>	<b>-4616%</b>	<b>-26%</b>	<b>-2140%</b>	<b>-4%</b>	<b>-632%</b>	<b>-31%</b>	<b>-32%</b>	<b>6%</b>	<b>-33%</b>	<b>-17%</b>	<b>29%</b>	<b>44%</b>	<b>63%</b>	<b>70%</b>
<b>EBITDAS Margin</b>	<b>-2606%</b>	<b>-13%</b>	<b>0%</b>	<b>18%</b>	<b>-6%</b>	<b>15%</b>	<b>14%</b>	<b>34%</b>	<b>13%</b>	<b>22%</b>	<b>47%</b>	<b>59%</b>	<b>67%</b>	<b>73%</b>
<b>Net Margin</b>	<b>-4429%</b>	<b>-26%</b>	<b>-2138%</b>	<b>-6%</b>	<b>-632%</b>	<b>-44%</b>	<b>-43%</b>	<b>-5%</b>	<b>-37%</b>	<b>-26%</b>	<b>22%</b>	<b>39%</b>	<b>60%</b>	<b>68%</b>

SOURCE: CAMAC Energy, Inc. documents filed with the SEC and Gar Wood Securities estimates

## DISCLOSURES

### Distribution of Ratings

Rating	Count	Percent	<u>I.B. last 12 months</u>	
			Count	Percent
BUY	11	100%	1	9%
HOLD	0	0%	0	00%
SELL	0	00%	0	00%
NO RATING	0	00%	0	00%

### Explanation of Ratings

- BUY: Describes stocks we expect to provide a total return (capital appreciation + yield) of 15% or more in the next 12-month period.
- HOLD: Describes stocks we expect to provide a total return (capital appreciation + yield) of plus or minus 15% or more in the next 12-month period.
- SELL: Describes stocks we expect to provide a total negative return (capital depreciation + yield) of 15% or more in the next 12-month period.
- NO RATING: Describes stocks that have their investment rating and/or target price temporarily removed for fundamental or compliance-based reasons.

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<u>Company</u>	<u>Disclosures</u>
CAMAC Energy, Inc.	6, 8

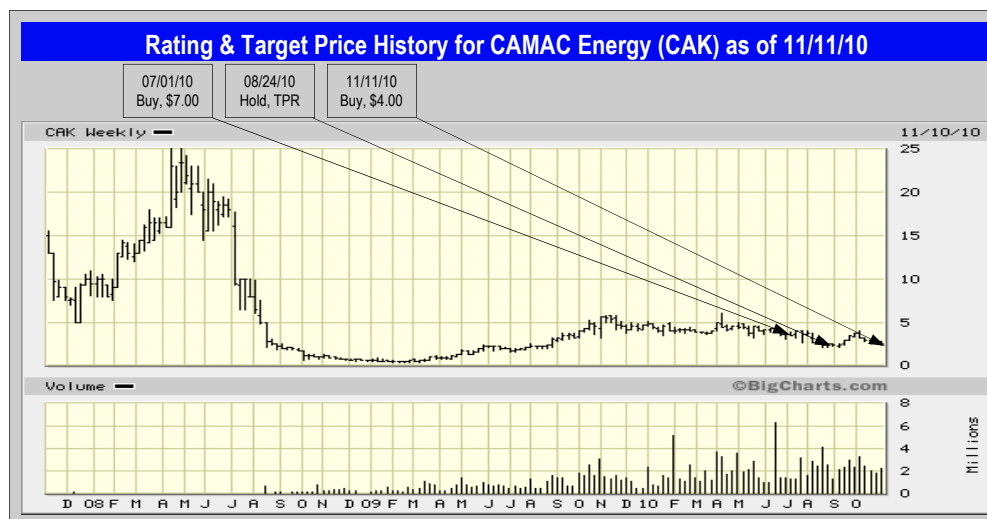
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