

# Cobalt International Energy (CIE)

## Q3'12 Wrap Up: Quiet Release; Exciting Outlook

- Company Update
- Estimate Change

- **Q3'12 Bottom Line** – Cobalt posted Q3'12 EPS/CPFS of -\$0.10/-0.04 vs our -\$0.12/-0.12 estimates and the Street consensus of -\$0.10/-0.04. The beat relative to our model was driven by lower-than-expected seismic and exploration expense in addition to lower dry hole expense and impairment charges.
- **GoM Well Results Expected Around YE12** – With no new well results or any significant changes in plans to announce, the Q3 earnings release was a bit of a non-event. However, Q4'12 and 2013 should be much more interesting, with two potential catalysts in the deepwater Gulf of Mexico expected around YE12 and a full drilling slate teed up for next year. First of all, we anticipate knowing the results of the Cobalt-operated **North Platte** #1 exploratory well (CIE 60% WI) this Dec. Gross unrisks resource potential for the prospect is estimated to be ~625 MMBOE and we assign a 35% risk factor, yielding 110 MMBOE of net risks potential, which we value at ~\$1.7bn (~\$4/share). Next, while progress on the Anadarko-operated **Shenandoah** #2 appraisal well (CIE 20% WI) has been slower than anticipated, management expects to have well results in the next few months. We estimate 431 MMBOE of gross unrisks resource potential and assign a 35% risk factor, yielding 25 MMBOE of net risks potential, valued at ~\$390mm (~\$1/share). Looking into 2013, CIE plans to drill the **Ardennes** #1 (42% WI) and the **Aegean** #1 (37.5% WI) exploration wells, and expects at least one outside operated GoM exploration well.
- **West Africa Drilling Slate** - Following rig malfunctions while drilling **Cameia** #2, the earliest that results from the lower zone would be released is late Q4'12. Next year, two Cobalt-operated drilling rigs should be running for most of 2013, with **Lontra** (40% WI), **Mavinga** (40% WI), and **Bicuar** (40% WI) on the drilling slate for offshore Angola, while TOTAL should spud the **Mango** #1 (CIE 21.25%) offshore Gabon.
- **Liquidity Update** – With ~\$1.5bn of cash and investments and a ~\$110mm drilling carry (at 9/30/12), CIE has more than enough liquidity to fund the ~\$0.7bn-\$1.0bn remaining in its exploration and appraisal program through 2013. However, CIE is considering various options (convertibles, high yield, JVs/farm outs and projecting financing) to fund the development programs needed to bring its discoveries online (first production still expected in early 2016 – Cameia and Heidelberg).
- **Adjusting Estimates** – For actual Q3'12 results and other fine tuning. Risked NAV remains at ~\$37 per share and we reaffirm our price target at 100% of this estimate.

<b>Buy/High Risk</b>	<b>1H</b>
Price (01 Nov 12)	US\$20.31
Target price	US\$37.00
Expected share price return	82.2%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>82.2%</b>
Market Cap	US\$8,339M

### Price Performance (RIC: CIE.N, BB: CIE US)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2011A	-0.05A	-0.05A	-0.12A	-0.13A	-0.35A	-0.35A
2012E	-0.09A	-0.35A	-0.10A	-0.21E	-0.75E	-0.63E
Previous	-0.09A	-0.35A	-0.12E	-0.21E	-0.77E	na
2013E	-0.24E	-0.24E	-0.24E	-0.24E	-0.98E	-0.56E
Previous	na	na	na	na	-0.97E	na
2014E	na	na	na	na	-0.98E	-0.51E
Previous	na	na	na	na	-0.97E	na

Source: Company Reports and dataCentral, Citi Research. FC Cons: First Call Consensus.

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### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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CIE.N: Fiscal year end 31-Dec						Price: US\$20.31; TP: US\$37.00; Market Cap: US\$8,339m; Recomm: Buy/High Risk					
Profit & Loss (US\$)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	0	0	0	0	0	PE (x)	-52.0	-57.4	-27.2	-20.8	-20.8
Cost of sales	na	na	na	na	na	PB (x)	4.1	3.4	3.1	3.8	3.4
Gross profit	na	na	na	na	na	EV/EBITDA (x)	-51.8	-51.9	-23.2	-18.7	-19.6
Gross Margin (%)	na	na	na	na	na	FCF yield (%)	-3.2	-2.9	-10.9	-8.7	-8.7
EBITDA (Adj)	-137,271	-137,103	-306,807	-400,664	-400,664	Dividend yield (%)	0	0	0	0	0
EBITDA Margin (Adj) (%)	na	na	na	na	na	Payout ratio (%)	0	0	0	0	0
Depreciation	-787	-733	-1,002	-1,202	-1,443	ROE (%)	-7.9	-7.0	-13.9	-19.1	-20.1
Amortisation	0	0	0	0	0	<b>Cashflow (US\$)</b>					
EBIT (Adj)	-138,058	-137,836	-307,809	-401,866	-402,107	EBITDA	-137,271	-137,103	-306,807	-400,664	-400,664
EBIT Margin (Adj) (%)	na	na	na	na	na	Working capital	0	0	0	0	0
Net interest	1,582	4,199	4,199	4,199	4,199	Other	4,007	-2,123	4,199	4,199	4,199
Associates	0	0	0	0	0	<b>Operating cashflow</b>	<b>-133,264</b>	<b>-139,226</b>	<b>-302,608</b>	<b>-396,465</b>	<b>-396,465</b>
Non-op/Except	0	0	0	0	0	Capex	-90,954	-85,000	-600,000	-325,000	-325,000
Pre-tax profit	-136,476	-133,637	-303,610	-397,667	-397,908	Net acq/disposals	0	0	0	0	0
Tax	0	0	0	0	0	Other	-758,372	-95,323	0	0	0
Extraord./Min.Int./Pref.div.	0	0	0	0	0	<b>Investing cashflow</b>	<b>-849,326</b>	<b>-180,323</b>	<b>-600,000</b>	<b>-325,000</b>	<b>-325,000</b>
Reported net profit	-136,476	-133,637	-303,610	-397,667	-397,908	Dividends paid	0	0	0	0	0
Net Margin (%)	na	na	na	na	na	<b>Financing cashflow</b>	<b>101,256</b>	<b>309,375</b>	<b>851,499</b>	<b>721,465</b>	<b>721,465</b>
Core NPAT	-136,476	-133,637	-303,610	-397,667	-397,908	<b>Net change in cash</b>	<b>-881,334</b>	<b>-10,174</b>	<b>-51,110</b>	<b>0</b>	<b>0</b>
<b>Per share data</b>						<b>Free cashflow to s/holders</b>	<b>-224,218</b>	<b>-224,226</b>	<b>-902,608</b>	<b>-721,465</b>	<b>-721,465</b>
Reported EPS (\$)	-0.39	-0.35	-0.75	-0.98	-0.98						
Core EPS (\$)	-0.39	-0.35	-0.75	-0.98	-0.98						
DPS (\$)	0	0	0	0	0						
CFPS (\$)	-0.38	-0.37	-0.74	-0.98	-0.98						
FCFPS (\$)	-0.64	-0.59	-2.22	-1.77	-1.77						
BVPS (\$)	4.90	5.92	6.52	5.39	5.98						
Wtd avg ord shares (k)	349,342	377,932	406,544	406,544	406,544						
Wtd avg diluted shares (k)	349,342	377,932	406,544	406,544	406,544						
<b>Growth rates</b>											
Sales revenue (%)	-100.0	na	na	na	na						
EBIT (Adj) (%)	-75.0	0.2	-123.3	-30.6	-0.1						
Core NPAT (%)	-74.1	2.1	-127.2	-31.0	-0.1						
Core EPS (%)	-18.0	9.5	-111.2	-31.0	-0.1						
<b>Balance Sheet (US\$)</b>											
Cash & cash equiv.	837,653	1,219,848	898,715	324,834	255,954						
Accounts receivables	0	0	0	0	0						
Inventory	0	0	0	0	0						
Net fixed & other tangibles	518,296	922,615	1,159,032	1,472,830	1,786,387						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	390,494	385,481	566,556	466,556	466,556						
<b>Total assets</b>	<b>1,746,443</b>	<b>2,527,944</b>	<b>2,624,303</b>	<b>2,264,220</b>	<b>2,508,897</b>						
Accounts payable	0	0	0	0	0						
Short-term debt	0	0	0	0	0						
Long-term debt	2,850	210,961	168,238	168,238	168,238						
Provisions & other liab	24,559	238,069	169,446	216,238	253,822						
<b>Total liabilities</b>	<b>27,409</b>	<b>449,030</b>	<b>337,684</b>	<b>384,476</b>	<b>422,060</b>						
Shareholders' equity	1,719,034	2,078,914	2,277,412	1,879,744	2,086,837						
Minority interests	0	0	0	0	0						
<b>Total equity</b>	<b>1,719,034</b>	<b>2,078,914</b>	<b>2,277,412</b>	<b>1,879,744</b>	<b>2,086,837</b>						
<b>Net debt</b>	<b>-834,803</b>	<b>-1,008,887</b>	<b>-730,477</b>	<b>-156,596</b>	<b>-87,716</b>						
Net debt to equity (%)	-48.6	-48.5	-32.1	-8.3	-4.2						

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 For definitions of the items in this table, please click [here](#).

Figure 1. CIE Q3'12 Variance Analysis

	Q3 2011 Actual	Q2 2012 Actual	Q3 2012 Actual	Q3 2012 CitiEstimate	Q3'12 Act. vs. Q3'12 CitiEst. % Diff.	Q3'12 Act. vs. Q3'11 Act. % Diff.	Q3'12 Act. vs. Q2'12 Act. % Diff.
<b>INCOME STATEMENT (\$ ,000)</b>							
Total Operating Revenues	0	0	0	0	NM	NM	NM
Operating Expense							
Seismic and exploration	4,757	12,006	6,327	12,000	-47.3%	33.0%	-47.3%
Dry hole expense and impairment	31,840	111,355	15,041	20,000	-24.8%	-52.8%	-86.5%
General & Administrative	11,459	18,482	18,916	18,482	2.3%	65.1%	2.3%
DD&A	186	312	269	220	22.3%	44.6%	-13.8%
<b>Total Operating Expenses</b>	<b>48,242</b>	<b>142,155</b>	<b>40,553</b>	<b>50,702</b>	<b>-20.0%</b>	<b>-15.9%</b>	<b>-71.5%</b>
Operating Income	(48,242)	(142,155)	(40,553)	(50,702)	NM	NM	NM
Interest Expense	0	0	0	0	NM	NM	NM
Interest Income	1,255	1,432	1,339	878	53%	6.7%	-6.5%
Income Before Taxes	(46,987)	(140,723)	(39,214)	(49,824)	NM	NM	NM
Total Income Taxes (Benefit)	0	0	0	0	NM	NM	NM
Effective % Tax Rate	0	0	0	0	NM	NM	NM
Reported Net Income (Loss)	(46,987)	(140,723)	(39,214)	(49,824)	NM	NM	NM
Reported NI (Loss) Per Share	(0.12)	(0.35)	(0.10)	(0.12)	NM	NM	NM
Reported NI (Loss) Per Diluted Share	(0.12)	(0.35)	(0.10)	(0.12)	NM	NM	NM
Recurring Net Income (Loss)	(46,987)	(140,723)	(39,214)	(49,824)	NM	NM	NM
Recurring Net Income (Loss) per Share	(0.12)	(0.35)	(0.10)	(0.12)	NM	NM	NM
Recurring NI (Loss) Per Diluted Share	(0.12)	(0.35)	(0.10)	(0.12)	NM	NM	NM
<b>Discretionary Cash Flow (\$ in thousands)</b>							
Net Income	(46,987)	(140,723)	(39,214)	(49,824)	NM	NM	NM
D.D. & A.	186	312	269	220	22.3%	44.6%	-13.8%
Exploration Expense (non-cash)	8,000	111,355	15,041	2,500	501.6%	88.0%	-86.5%
<b>Discretionary Cash Flow</b>	<b>(38,801)</b>	<b>(18,951)</b>	<b>(14,697)</b>	<b>(47,105)</b>	<b>NM</b>	<b>NM</b>	<b>NM</b>
Discretionary Cash Flow Per Diluted Share	(0.10)	(0.05)	(0.04)	(0.12)	NM	NM	NM

Source: Citi Research

Figure 2. Cobalt International Energy NAV

Country/Trend		Risk Factor (%)	Co WI Interest (%)	Co Net Entitlement Interest (%)	Operator	Gross Unrisked Resource (mmboe)	Net Risked Resource (mmboe)	NPV (\$/ bbl)	NPV (\$m)	NPV \$/share	Discount Factor	\$90 Oil NPV @ Discovery \$/bbl
<b>2012 Exploration</b>												
Heidelberg #2	US GOM Miocene	80.0%	9.38%	7.88%	APC	294	19	\$24.55	\$454	\$1.11	0.91	\$27.00
Cameia-1	Angola	80.0%	40.00%	26.00%	CIE	1,000	208	\$5.45	\$1,135	\$2.77	0.91	\$6.00
Cameia-2	Angola	70.0%	40.00%	26.00%	CIE	1,200	218	\$5.45	\$1,191	\$2.91	0.91	\$6.00
North Platte	US GOM Lower Tertiary	35.0%	60.00%	50.40%	CIE	625	110	\$15.45	\$1,704	\$4.16	0.91	\$17.00
Shenandoah	US GOM Lower Tertiary	35.0%	20.00%	16.80%	APC	431	25	\$15.45	\$392	\$0.96	0.91	\$17.00
<b>2013 Exploration</b>												
Aegean	US GOM Lower Tertiary	18.0%	37.50%	31.50%	CIE	469	27	\$14.05	\$373	\$0.91	0.83	\$17.00
Ardennes	US GOM Miocene	16.0%	42.00%	35.28%	CIE	171	10	\$22.31	\$215	\$0.52	0.83	\$27.00
Ardennes	US GOM Lower Tertiary	18.0%	42.00%	35.28%	CIE	204	13	\$14.05	\$182	\$0.44	0.83	\$17.00
Rum Ramsey	US GOM Miocene	16.0%	24.00%	20.16%	BHP	184	6	\$22.31	\$132	\$0.32	0.83	\$27.00
Racer	US GOM Miocene	16.0%	24.00%	20.16%	BHP	196	6	\$22.31	\$141	\$0.34	0.83	\$27.00
Racer	US GOM Lower Tertiary	18.0%	24.00%	20.16%	BHP	295	11	\$14.05	\$150	\$0.37	0.83	\$17.00
Mango	Gabon	16.0%	21.25%	6.00%	TOT	2,484	24	\$15.70	\$374	\$0.91	0.83	\$19.00
Mavinga (Bl.21)	Angola	50.0%	40.00%	26.00%	CIE	1,000	130	\$4.96	\$645	\$1.57	0.83	\$6.00
Bicuar-1	Angola	50.0%	40.00%	26.00%	CIE	1,000	130	\$4.96	\$645	\$1.57	0.83	\$6.00
Loengo (Bl.9)	Angola	40.0%	40.00%	26.00%	CIE	800	83	\$4.96	\$413	\$1.01	0.83	\$6.00
Lontra (Bl. 20)	Angola	33.0%	40.00%	12.00%	CIE	3,900	154	\$9.09	\$1,404	\$3.43	0.83	\$11.00
<b>2014 and Beyond</b>												
Lyell	US GOM Miocene	16.0%	15.00%	12.60%	APC	69	1	\$18.36	\$25	\$0.06	0.68	\$27.00
Rocky Mountain	US GOM Miocene	16.0%	45.00%	37.80%	CIE	137	8	\$18.36	\$152	\$0.37	0.68	\$27.00
Saddlebred	US GOM Miocene	16.0%	60.00%	50.40%	CIE	301	24	\$18.36	\$445	\$1.09	0.68	\$27.00
Goodfellow	US GOM Lower Tertiary	18.0%	29.00%	24.36%	ENI	347	15	\$11.56	\$176	\$0.43	0.68	\$17.00
Latvian	US GOM Lower Tertiary	18.0%	60.00%	50.40%	CIE	102	9	\$11.56	\$107	\$0.26	0.68	\$17.00
Williams Fork*	US GOM Lower Tertiary	18.0%	36.00%	30.24%	NXV	295	16	\$11.56	\$186	\$0.45	0.68	\$17.00
Caspian	US GOM Lower Tertiary	18.0%	60.00%	50.40%	CIE	408	37	\$11.56	\$428	\$1.05	0.68	\$17.00
South Platte	US GOM Lower Tertiary	18.0%	60.00%	50.40%	CIE	215	20	\$11.56	\$226	\$0.55	0.68	\$17.00
Baffin Bay	US GOM Lower Tertiary	18.0%	60.00%	50.40%	CIE	261	24	\$11.56	\$274	\$0.67	0.68	\$17.00
Rainbow	Gabon	16.0%	21.25%	6.00%	TOT	3,887	37	\$12.92	\$482	\$1.18	0.68	\$19.00
Pioneer	Gabon	16.0%	21.25%	6.00%	TOT	2,212	21	\$12.98	\$276	\$0.67	0.68	\$19.00
Monte Carlo	Angola	20.0%	40.00%	26.00%	CIE	1,972	103	\$4.10	\$420	\$1.03	0.68	\$6.00
Silver Dollar	Angola	20.0%	40.00%	26.00%	CIE	1,214	63	\$4.10	\$259	\$0.63	0.68	\$6.00
Eldorado	Angola	20.0%	40.00%	26.00%	CIE	1,068	56	\$4.08	\$227	\$0.55	0.68	\$6.00
Silverado	Angola	20.0%	40.00%	26.00%	CIE	582	30	\$4.08	\$123	\$0.30	0.68	\$6.00
Treasure Island	Angola	20.0%	40.00%	26.00%	CIE	777	40	\$4.08	\$165	\$0.40	0.68	\$6.00
Elstar	Angola	16.5%	40.00%	12.00%	CIE	1,100	22	\$7.48	\$163	\$0.40	0.68	\$11.00
Haas	Angola	16.5%	40.00%	12.00%	CIE	796	16	\$7.48	\$118	\$0.29	0.68	\$11.00
Other	US GOM Miocene	16.0%	40.00%	33.60%	CIE/Others	1,302	70	\$5.34	\$374	\$0.91	0.20	\$27.00
Other	US GOM Lower Tertiary	18.0%	41.00%	34.44%	CIE/Others	1,724	107	\$3.36	\$359	\$0.88	0.20	\$17.00
Other	Gabon	16.0%	21.25%	6.00%	TOT	14,304	137	\$3.76	\$516	\$1.26	0.20	\$19.00
Other	Angola Blocks 9 and 21	20.0%	40.00%	26.00%	CIE	4,443	231	\$1.19	\$274	\$0.67	0.20	\$6.00
Other	Angola Block 20	16.5%	40.00%	12.00%	CIE	12,737	252	\$2.18	\$549	\$1.34	0.20	\$11.00
						2,514	Subtotal:	\$15,874				
									<b>NAV Total: \$15,874</b>			
									Cash: \$1,203			
									Restricted Cash: \$477			
									Current Debt: \$0			
									Long-Term Debt: \$168			
									Net Debt: -\$1,512			
									NPV of Future Capital Spending: \$2,129			
									<b>Equity Valuation: \$15,257</b>			
									Shares Outstanding: 409			
									Equity Valuation Per Share: \$37.3			

Source: Company reports and Citi Research

## Cobalt International Energy

### Company description

Cobalt International Energy is an exploration company focused on the Gulf of Mexico and West Africa. Currently, the company has no proven reserves or production as up until now, it has been in the "access," or lease acquisition phase of its development. However, with that phase now largely complete, the company is shifting gears to the drilling of its massive portfolio. It has recently made a large discovery offshore Angola with its success at Cameia prospect which is estimated to hold up to 2 Bn barrels of recoverable oil resources. We also look for results from two more high-impact wells from West Africa and in the Gulf of Mexico late this year/early next year to be the next catalysts for the stock. The company is headquartered in Houston, TX.

### Investment strategy

We rate Cobalt Buy/High Risk (1H). Cobalt has no debt, it is fully funded through 2013 and we believe that it could farm down interests in some of its acreage to cover capital spending beyond then. Further, we believe that the market is giving very little value to the prospects that will be drilled post 2012, and thus there could be significant upside.

### Valuation

Our \$37 price target is based on the stock achieving a ~100% of our risked NAV estimate based on a "normalized" spot crude oil price of \$90/Bbl. Since the company does not currently generate cash flow and will not begin to do so for at least the next four years, multiple analysis is not applicable to the shares.

### Risks

We rate Cobalt High Risk based on a combination of quantitative and qualitative risk assessments compared to other stocks covered by Citi Investment Research.

- Exploration drilling results - While Cobalt already made a large hydrocarbon discovery with its success at Cameia offshore Angola, it still has a broad inventory of high-impact prospects which could have a very large impact on share price.
- Issues with bringing a discovery to production - Post Cameia or any other discovery, it will be key for Cobalt to demonstrate the ability to smoothly bring the discovery on line. Any potential delays or unforeseen problems that might hint at inexperience with securing the necessary equipment, contractors, and agreements, will likely be negatively perceived by investors.
- Funding/capital markets risk - Even though Cobalt is well funded through the end of 2013, there will still inevitably be a lag between the time when the current sources of liquidity runs out and the company's initial cash flow generation. Thus, should capital markets conditions be poor at the time when Cobalt next needs to access capital, the company will likely find decreased investor appetite to fund development activity or a continued high risk exploration program.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

# Appendix A-1

## Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

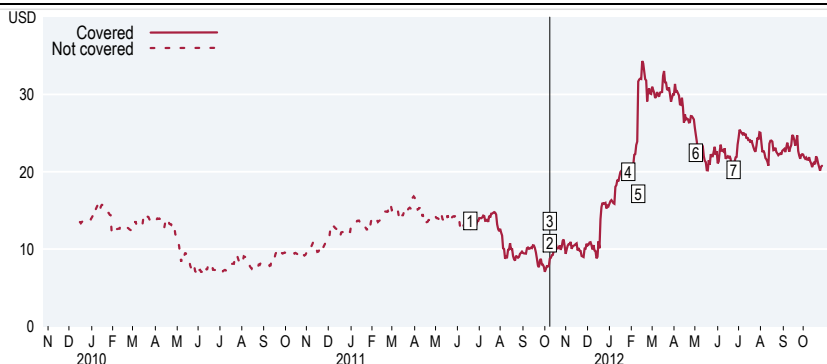
## IMPORTANT DISCLOSURES

### Cobalt International Energy (CIE)

#### Ratings and Target Price History Fundamental Research

Analyst: Joseph Stewart

Covered since January 27 2012



	Date	Rating	Target Price	Closing Price
1	20-Jun-11	*1S	*18.00	12.58
2	8-Oct-11	Stock rating system changed		
3	8-Oct-11	*1H	18.00	7.77

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	27-Jan-12	1H	*26.00	20.43
5	10-Feb-12	1H	*42.00	31.68
6	2-May-12	1H	*40.00	24.75

	Date	Rating	Target Price	Closing Price
7	25-Jun-12	1H	*37.00	20.66

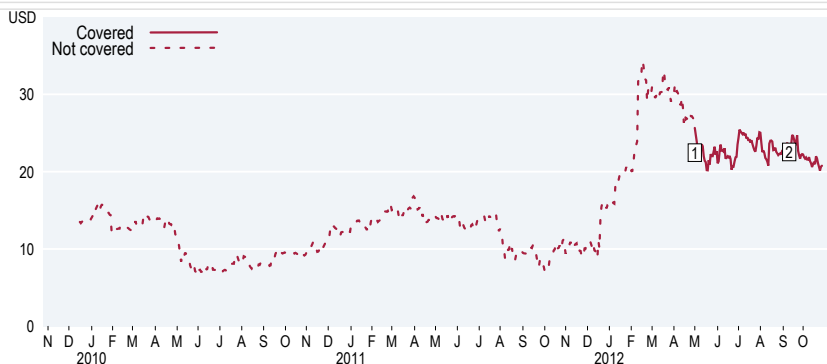
Rating/target price changes above reflect Eastern Standard Time

### Cobalt International Energy (CIE)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Joseph Stewart

Covered since January 27 2012



	Date	Rating	Target Price	Closing Price
1	1-May-12	*ADD MP	-	25.66

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	11-Sep-12	*REM MP	-	22.59

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 4 Oct 2012

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
51%	38%	11%	7%	85%	7%
50%	47%	45%	59%	47%	50%

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