

Otto Energy Ltd

(OEL \$0.045) Buy

Analyst	Date	Price Target
Jon Bishop	19 th June 2019	\$0.09/sh

OEL – A Clear Valuation Disconnect

Investment case

The market appears to be valuing OEL on only its proven-developed-producing (1P) Reserves from SM71. This is based on our 6.1cps NPV for OEL's SM71 interest, sense-checked against recent US Gulf of Mexico ('GoM') Acquisition and Divestment ('A&D') transactions. Though we acknowledge the current anaemic oil sector macro, we view that this disconnect is unsustainable medium to long term. Particularly noting that the Company is currently realising initial production (and expandable) and maiden Reserves from a second production asset at Lightning, and appear to have substantiated a third production development that could be on-stream within 18mnths. We maintain our Buy recommendation and 9cps Price Target.

Key points

- OEL is trading at a substantial discount to fair value on just its SM71 producing asset on our DCF (NPV10) analysis equating to 6.1cps;
- This is before accounting for additional production from the Lightning development that commenced in May;
- And finally, not accounting for the recent successful Green Canyon "Bulleit" appraisal well that appears to support a third development;
- We have sense checked our observations by comparing OEL to recent GoM A&D transactions:
 - Anadarko purchase of 'Lucius' (2016);
 - Kosmos purchase of Deep Gulf Energy (2018);
 - Delek Group purchase of Ceasar-Tonga Field (2019);
 - Murphy Oil purchase of LLOG's GoM interests (2019);

GoMex Transactions, all figures in US\$ unless otherwise stated				Transaction Summary			
Acquirer	Target/asset	Asset Name	Date	"purchase price (\$m)"	\$/Flow boe	\$/BOE (1p)	\$/BOE (2p)
Murphy Oil Corp	"GoM assets from LLOG expl & LLOG bluewater hold."	Numerous - 26 GoM blocks	2019	1,375	36,184	20.83	11.27
Delek Group	Shell	Ceasar - Tonga field	2019	965	60,313	na	12.37
Kosmos Energy	Deep Gulf Energy		2018	1,225	49,000	na	15.31
Anadarko	Freeport-McMoRan Oil & Gas	Lucius	2016	2,000	21,000	13.5	na
Average				1,391	41,624	17.17	12.98
					EV		
Otto Energy	Current	SM71, Lightning		90	27,818	16.11	6.44

- These transactions indicate that:
 - Production is valued at US\$41.6k/flowing boe;
 - Proven (1P) Reserves are valued at US\$17.2/boe;
 - Proven&Probable (2P) Reserves are value at US\$13.0/boe;
- This compares with OEL currently trading at:
 - US\$27.8k/flowing boe (circa 75% oil-condensate currently);
 - US\$16.1/boe 1P Reserves;
 - US\$6.4/boe 2P Reserves;
- We see an increasing valuation disconnect noting OEL is:
 - Pending significant upgrade to Reserves on acct of Lightning;
 - Expansion to Lightning maiden production within 12mnths;
 - Development and maiden production from Green Canyon within 18mnths;
- Buy maintained: The market is clearly valuing OEL on SM71 proven producing Reserves only;
- Our 9cps Valuation and Price Target assumes risked valuation for Lightning and negligible value for Green Canyon.

Otto Energy Ltd	Year End 30 June	
Share Price	0.045	A\$/sh
Price Target	0.09	A\$/sh
Valuation	0.090	A\$/sh

Shares on issue*	2505	m, diluted
Market Capitalisation	113	A\$m
Enterprise Value	88	A\$m
Debt	0	A\$m
Cash	25	A\$m
Largest Shareholder	Perennial - 10.5%	
<i>*fully diluted</i>		

Production F/Cast	DecH 19a	2019f	2020f
Attrib. Prod'n (mmbboe)	0.4	0.8	0.8

Assumptions	DecH 19a	2019f	2020f
Avg LLS Oil Price Rec'	65	62	63
AUDUSD	0.77	0.75	0.71

Key Financials	DecH 19a	2019f	2020f
Revenue (US\$m)	17	36	36
EBITDA (US\$m)	13	27	25
NPAT (US\$m)	-4	-5	6
Cashflow (US\$m)	16	26	26

CFPS (Ac)	1	1	1
P/CFPS (x)	0.0	3.3	3.1

EPS (Ac)	0	0	0
EPS growth (%)	0%	na	na
PER (x)	0.0	na	12.3

EV:EBITDA (x)	6.6	3.3	3.8
EV:EBIT (x)	-19.6	-18.0	16.2

DPS (Ac)	0.0	0.0	0.0
Dividend Yield (%)	0%	0%	0%

ND:Net Debt+Equity (%)	0%	na	na
Interest Cover (x)	0.0	na	na

Share Price Chart



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Analysis

OEL's share price has significantly underperformed in the past few weeks.

This is despite bringing into production a second development at the Lightning onshore discovery and the strong stable production performance from its existing shallow water, offshore SM71 oil development.

What is more incredulous, is that the Company has recently announced that the first of the two target reservoirs within the Bulleit-1 well, appraising the Green Canyon 21 Field, GoM, has intersected a commercial volume of oil.

Given the access to the neighbouring Green Canyon-18 oil development platform, Green Canyon 21 can be brought on-stream within 18mnths adding upto an additional 2,500bbls/d net to OEL.

To highlight the disconnect OEL's share price has to what we estimate to be fair value, we have sense checked out SOTP 9cps valuation:

ASSET VALUATION	A\$m	A\$/sh
South Marsh 71	153	0.061
Lightning (50% disc to NAV)	46	0.018
Corporate	(33)	(0.013)
Exploration	35	0.014
Unpaid Capital	-	-
Debt	-	-
Cash	25	0.010
Total	162	0.090

to recent US A&D transactions focused upon the GoM:

GoMex Transactions, all figures in US\$ unless otherwise stated				Transaction Summary				Mboe/d	Mboe/d	2018 Net (mmboe)		Notes
Acquirer	Target/asset	Asset Name	Date	"purchase price (\$m)"	\$/Flow boe	\$/BOE (1p)	\$/BOE (2p)	Curr Prod	FY+1 prod	1P	2P	
Murphy Oil Corp	"GoM assets from LLOG expl & LLOG bluewater hold."	Numerous - 26 GoM blocks	2019	1,375	36,184	20.83	11.27	38	33.5	66	122	-up to \$250m add. Conting payments
Delek Group	Shell	Cesar - Tonga field	2019	965	60,313	na	12.37	16			78	-to acquire the sellers 22.45% stake
Kosmos Energy	Deep Gulf Energy		2018	1,225	49,000	na	15.31	25			80	
Anadarko	Freeport-McMoRan Oil & Gas	Lucius	2016	2,000	21,000	13.5	na					-up to \$150m add. Conting payments
Average				1,391	41,624	17.17	12.98					
				EV								
Otto Energy	Current	SM71, Lightning		90	27,818	16.11	6.44	2.2	4.2	3.8	9.5	

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We have then looked out for the next two calendar years to account for where OEL's group production will likely be with the incorporation of Green Canyon-21 (CY20) and Lightning fully developed (CY21):

Otto Energy	Current	SM71, Lightning	90	27,818	16.11	6.44
	CY20	SM71, Lightning, Green Canyon	90	14,571	10.74	4.53
	CY21	SM71, Lightning Expanded, Green Canyon	90	11,769	8.50	3.71
		PEER COMPS		41,624	17.17	12.98

Ordinarily we might explain the disconnect on account of the lead time to commercialisation and/or required development capex. However:

- Lightning is currently on production and the incremental cost to expand will be funded from cashflow over the intervening 2yrs; and
- Green Canyon development tie back requires net capex of circa US\$15-20m.

OEL has circa US\$15m in cash, no debt, cash flow and an increasing capacity to secure Reserve Based Lending.

Parsing through the aforementioned A&D comps, we generate look-through share prices implied:

Implied Share Price (cps)	US Transaction Metrics			
	Production Year	US\$41,600 per flowing boe	1P - \$17.2/boe	2P - \$13.0/boe
	Current	6.73	4.80	9.07
	CY20	12.85	7.19	12.89
	CY21	15.92	9.09	15.75

Clearly at the current share price, the market values only OEL's proven developed producing Reserves relating to SM71.

We are of the view that the valuation disconnect is unsustainable on a fundamentals basis (and ignoring exploration and expansion upside potential) given:

1. The Company is pending maiden production data and Reserves at Lightning;
2. Appraisal results from the deeper primary reservoir at Green Canyon;
3. Has an exceptional Management team for a small company;
4. And its Balance sheet is debt free, has cash and is producing high margin barrels of oil equivalent from two assets.

Buy maintained.

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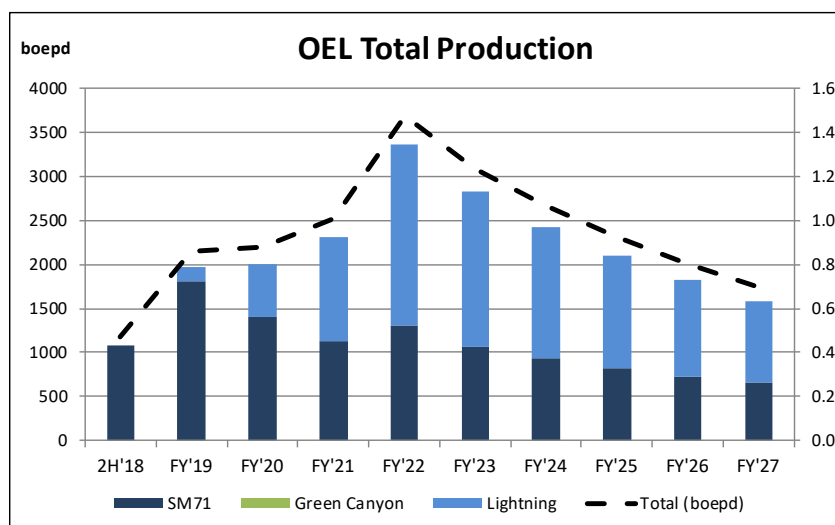
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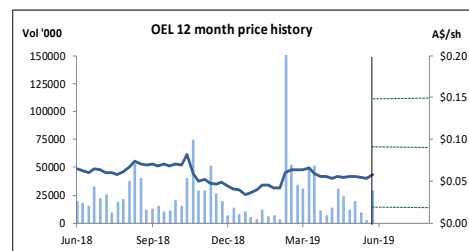
Key Variables

Val/ Sh	Brent \$/bbl									
	0.090	-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%
AUDUSD	15%	\$0.06	\$0.07	\$0.07	\$0.07	\$0.08	\$0.08	\$0.08	\$0.09	\$0.09
	10%	\$0.07	\$0.07	\$0.07	\$0.08	\$0.08	\$0.09	\$0.09	\$0.09	\$0.10
	5%	\$0.07	\$0.07	\$0.08	\$0.08	\$0.09	\$0.09	\$0.09	\$0.10	\$0.10
	0%	\$0.07	\$0.08	\$0.08	\$0.09	\$0.09	\$0.09	\$0.10	\$0.10	\$0.11
	-5%	\$0.08	\$0.08	\$0.09	\$0.09	\$0.09	\$0.10	\$0.10	\$0.11	\$0.11
	-10%	\$0.08	\$0.09	\$0.09	\$0.10	\$0.10	\$0.10	\$0.11	\$0.11	\$0.12
-15%	\$0.09	\$0.09	\$0.10	\$0.10	\$0.11	\$0.11	\$0.11	\$0.12	\$0.12	



Euroz Forecast	FY'18	FY'19	FY'20	FY'21	FY'22	FY'23
Sales Gas TERM (A\$)	\$3.24	\$3.13	\$2.88	\$3.00	\$3.00	\$3.00
LLS US\$/bbl	\$62	\$69	\$72	\$83	\$85	\$85
AUDUSD	\$0.78	\$0.75	\$0.71	\$0.74	\$0.75	\$0.75

Our Share Price Sensitivity



Our Market Sensitivity

Valuation - \$0.090/sh

Price Target - \$0.090/sh

Bull Scenario - \$0.15/sh

Oil prices rise quickly towards US\$100/bbl and the scale of the Lightning development increases substantially. OEL continues to have success with the drill-bit during the ongoing exploration/appraisal programme.

Base Scenario - \$0.090/sh

The stock is repriced by the market after incorporating the production and earnings related to the scaled development of the Lightning gas-condensate discovery. Oil prices continue to firm.

Bear Scenario - \$0.02/sh

Operational impacts and/or accelerated production declines at SM71 significantly reduce Reserves and therefore economic field life. And or oil prices collapse.

Company Summary

Otto Energy Ltd (OEL) is a US Gulf Coast oil & gas exploration and production company. OEL currently on production, brownfields appraisal and exploration of conventional shallow water and onshore oil and gas fields.

SM71 (South Marsh Island) located in shallow GoM is OEL's current production asset, producing gross +1mmbboe since commissioning in Mar'18. Current 50% working interest (NRI 40%) and net 2P reserves are -6.6mmbboe (90% oil). The Lightning discovery (37.5% WI) will commence commercial sales from Jun Q, 2019.

Disclaimer

The projections and information above is based on the set assumptions outlined. Due care and attention has been used in the preparation of this information. However actual results may vary from forecasts and any variation may be materially positive or negative. Forecasts by their very nature, are subject to uncertainty and contingencies, many of which are outside the control of Euroz.

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(OEL \$0.045) Buy



Market Statistics				Year End 30 June			
Share Price	\$0.045	A\$/sh	Directors				
Issued Capital			J Jetter			NE Chair	
FP Ord	2,457.9	m	M Allen			MD	
Opt. (var)	-	m	I Macliver			NED	
Perf Rightst	46.8	m	I Boserio			NED	
Total Dil. FPOrd	2,504.7	m	P Senyia			NED	
			K Small			NED	
Market Capitalisation	\$113	m	Shareholders				
Enterprise Value	\$88	m	Molton Holdings Ltd	12.4%			
Debt	\$0	m	Perennial	10.5%			
Cash	\$25	m	Colonial	4.1%			
Asset Valuation				A\$m	A\$/sh		
South Marsh 71			153			0.061	
Lightning (50% disc to NAV)			46			0.018	
Corporate			(33)			(0.013)	
Exploration			35			0.014	
Unpaid Capital			-			-	
Debt			-			-	
Cash			25			0.010	
Total			162			0.090	
F/Cast Production (A\$m)				DecH 19a	2019f	2020f	2021f
Attrib. Prod'n (mmbboe)							
SM 71			0.38	0.73	0.56	0.45	
Lightning			-	0.06	0.24	0.47	
Green Canyon							
Total Gas (Bscf)			0.47	1.23	1.83	2.89	
Total Oil-cond (mmbbls)			0.30	0.57	0.46	0.37	
Total Attrib (mmbboe)			0.38	0.79	0.80	0.92	
Av. net Production (kbbboe/d Pre-royalty)				2.09	2.15	2.20	2.53
Op. Costs (inc. roy. & state tax) - \$/boe				14.25	14.74	15.58	17.74
Assumptions							
Avg LLS Oil Price (US\$/bbl)			64.9	67.3	70.4	80.5	
Avg LLS Oil Price Rec'd (A\$/bbl)			64.9	62.3	63.4	73.5	
Avg Henry Hub Price (A\$/GJ)			2.9	3.1	2.9	3.0	
US\$:A\$			0.77	0.75	0.71	0.74	
Ratio Analysis (A\$m)				DecH 19a	2019f	2020f	2021f
CF (US\$m)			16	26	26	34	
CF / Sh (Ac/sh)			1	1	1	2	
CF Ratio (x)			-	3.3	3.1	2.4	
Earnings (A\$m)			(6)	(6)	9	19	
EPS (Ac/sh)			(0.3)	(0.3)	0.4	0.8	
EPS Growth (%)			0%	na	na	112%	
Earnings Ratio (x)			-	na	12	6	
E'prise Val. (A\$m)			163	131	136	135	
EV : EBITDA (x)			6.6	3.3	3.8	3.0	
EV : EBIT (x)			(19.6)	(18.0)	16.2	7.3	
Net Debt / ND+Eq (%)			0%	na	na	na	
Interest Cover (x)			-	na	na	na	
EBIT Margin (%)			0%	na	17%	30%	
ROE (%)			0%	-11%	14%	25%	
ROA (%)			0%	-10%	11%	22%	
Div. (Ac/sh)			-	-	-	-	
Div. payout ratio			-	-	-	-	
Div. Yield			-	-	-	-	
Div. Franking			-	-	-	-	
Profit and Loss (A\$m)				DecH 19a	2019f	2020f	2021f
Oil Equivalent Sales			21	44	44	56	
LESS Royalties			(4)	(8)	(8)	(10)	
Deferred Revenue			-	-	-	-	
Interest Revenue			-	0	1	1	
Other Revenue			-	-	-	-	
TOTAL REVENUE			17	36	36	46	
Operating Costs			1	3	4	6	
Dep/Amort			2	3	3	4	
Writeoffs (explor)			18	30	16	16	
Corp O/H			3	6	6	6	
Provisions			(2)	(2)	-	-	
EBITDA			13	27	25	33	
EBIT			(4)	(5)	6	14	
Interest Expense			-	-	-	-	
NPBT			(4)	(5)	6	14	
Tax			-	-	-	-	
NPAT			(4)	(5)	6	14	
Minority Interest			-	-	-	-	
NET PROFIT			(4)	(5)	6	14	
Net Abnormal Profit/(Loss) after Tax			-	-	-	-	
Net Profit After Abnormal			(4)	(5)	6	14	
Cash Flow (A\$m)				DecH 19a	2019f	2020f	2021f
+ Net Profit			(4)	(5)	6	14	
+ Working Capital Adjustment			(1)	(1)	-	-	
+ Dep/Amort			2	3	3	4	
+ Provisions, W/O			16	28	16	16	
+ Tax Expense			-	-	-	-	
- Tax Paid			-	-	-	-	
- Deferred Revenue			-	-	-	-	
= Operating Cashflow			12	26	26	34	
-Capex + Development			2	6	4	17	
-Exploration			19	34	20	20	
-Assets Purchased			-	-	-	-	
+Asset Sales			-	-	-	-	
+Other			(1)	(1)	-	-	
= Investing Cashflow			(22)	(40)	(24)	(37)	
+ Equity Issues (Rts,plc,opts)			15	37	-	-	
+Loan Drawdown/Receivable			-	-	-	-	
+Other			(1)	(2)	-	-	
-Loan Repayment			-	11	-	-	
-Dividends			-	-	-	-	
= Financing Cashflow			14	24	-	-	
Period Surplus			4	9	1	(3)	
Adj. FX effects			-	-	-	-	
CASH			10	15	16	13	
Balance Sheet (A\$m)				DecH 19a	2019f	2020f	2021f
Assets							
Cash			10	15	16	13	
Current Receivables			4	4	4	4	
Other Current Assets			0	0	0	0	
Non-Current Assets			28	30	31	45	
Total Assets			43	50	52	62	
Liabilities							
Borrowings			10	-	-	-	
Current Accounts Payable			5	5	5	5	
Non-Current Liabilities			-	-	-	-	
Other Liabilities			1	1	1	1	
Total Liabilities			16	6	6	6	
Net Assets			27	44	46	56	
Reserves and Resources					Oil	Gas	Total
				mmbbls	Bcf	mmboe	
2P (Net Revenue Interest)							
SM71				5.89	4.20	6.6	
Lightning (est.)				0.56	14.2	2.9	
EV / 2P boe (A\$)						9.2	
EV / 2P+2C boe (A\$)						9.2	

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