

24 Jul 2012

Share Price: \$0.084
12mth Price Target: \$0.18

OTTO ENERGY LTD

Foundations in Place for an Eventful 2013

Otto Energy Ltd ("Otto", "OEL", "Company") has completed its first quarter since the Galoc field recommenced production. The field has performed as expected which positions the Company well for a new financial year that could see up to five wells drilled.

Galoc produced 534,405 barrels of oil for the quarter

Galoc came back on line at a respectable 6,300 barrels of oil per day, producing 534,405 (176,354 net) barrels for the quarter. Production in the first quarter was managed well, with production rates of 6,100 barrels per day at the end of the quarter.

Only one cargo of 325,546 (107,430 net) barrels was lifted during the quarter, resulting in US\$10.9m in revenue. This means that there was ~210,000 barrels of oil yet to be lifted (~\$7m of net revenue to Otto) at 30 June 2012.

Phase 2 should be the next piece of news

Otto has started ordering long lead items for the Phase 2 development. This, coupled with Nido Petroleum Ltd's (NDO.asx) recent announcement that it has secured \$30m in funding for its share of the Phase 2 development, indicates that FID cannot be too far away and should be a certainty.

Success with the Phase 2 development should see the 2C resource of 4.5 (1.5 net) million barrels of oil proved up to a reserve.

Still waiting for SC55

There is still no news on the timing of a well in SC55. In our opinion, this is the major catalyst for Otto in the medium term. The market is bound to get excited when BHP starts drilling a 2.1Tcf and 74 million barrels recoverable prospect that Otto will hold a 33% interest and could be worth as much as \$600m on a success case.

Buy – In control of dependable production

Otto's management have really proven themselves over the last 12 months by increasing their stake in Galoc, taking on the role of operator, advancing Phase 2 planning and getting the field into a position to provide another five years of production.

We are disappointed that a well in SC55 has not been drilled yet and there is still no indication of when the Cinco prospect will be drilled. However, this is out of Otto's hands. The only consolation is that this well should be drilled within the next 12 months.

We recommend Otto as a Buy with a price target of 18cps. Phase 2 FID will be a positive for the stock but we believe there won't be a great deal of share price appreciation until there is some clarity on the timing of a well into SC55.

Brief Business Description:

Oil production offshore Philippines. Prospective exploration portfolio offshore Philippines.

Hartleys Brief Investment Conclusion

Free carried on two high impact wells in SC55 by BHP.

Chairman & CEO:

Mr Rick Crabb (Non Exec Chairman)
Mr Gregor McNab (CEO)

Top Shareholders:

Santo Holdings AG (21.3%)
Molton Holdings Ltd (21.3%)
Acorn Capital Limited (7.4%)

Company Address:

32 Delhi St
West Perth, WA, 6005

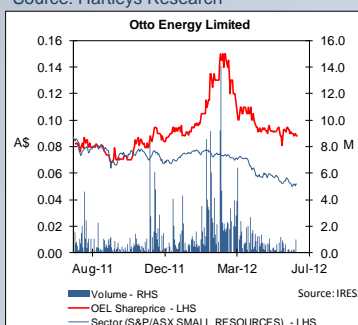
Valuation: \$0.28
Issued Capital: 1138.3m
- fully diluted 1165.3m
Market Cap: \$95.6m
- fully diluted \$97.9m
Debt (31 Dec '11): \$0.0m
Cash Equiv (31 Dec '11): \$29.5m

	FY11a	FY12e	FY13e
Prodn (mboe)	0.485	0.478	0.595
Op Cash Flw	\$8.5m	\$0.0m	\$19.2m
Free Cash Flw	-\$3.7m	\$0.0m	\$15.9m
NPAT* (A\$m)	\$12.5m	-\$4.5m	\$18.4m
EPS (\$, bas)*	1.1x	-0.4x	1.6x
P/E (basic)*	7.7x	-21.2x	5.3x
EV / EBITDA	5.8x	22.3x	3.2x
DPS (\$)	-	-	1.000
Franking	100%	100%	100%
Dividend Yield	0.0%	0.0%	0.0%
N.D. / equity	0%	0%	0%
Chg in Cash	6.9	-7.0	15.3

Net Cash End \$33.2m \$27.6m \$43.0m
2P Reserve (mmbbl) 1.89
EV / 2P Reserve \$34.98

*normalised

Source: Hartleys Research



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SUMMARY MODEL

Otto Energy Limited OEL		Share Price \$0.084				July 2012 BUY					
Key Market Information						Directors					
Share Price		\$0.084				Mr Rick Crabb (Non Exec Chairman)					
Market Capitalisation		\$95.6m				Mr Rufino Bomasang (Non Exec Director)					
52 Week High-Low		\$0.09-\$0.07				Mr John Jetter (Non Exec Director)					
Issued Capital		1138.3m				Mr Ian MacIver (Non Exec Director)					
Issued Capital (fully diluted inc. ITM options)		1165.3m				Mr Ian Boserio (Non Exec Director)					
Options		68.0m				Mr Gregor McNab (Chief Executive Officer)					
Hedging						32 Delhi St					
Yearly Turnover/Volume		\$34.5m/328.6m shares				West Perth, WA, 6005					
Liquidity Measure (Yearly Turnover/Issued Capital)		27%				Tel: (08) 6467 8800					
Valuation						Fax: (08) 6467 8801					
Discounted Cashflow @ 10% Real		\$0.28				Web: http://www.ottoenergy.com.au					
12 Month Price Target		\$0.18									
Financial Performance						Substantial Shareholders					
	Unit	FY2011A	FY2012F	FY2013F	FY2014F		m shares	%			
Net Revenue	A\$m	22.1	34.0	51.4	84.2	Santo Holdings AG	241.9	21.3			
Total Costs/Writeoffs	A\$m	(10.7)	(31.0)	(31.0)	(31.9)	Molton Holdings Ltd	241.9	21.3			
EBITDA	A\$m	11.4	3.0	20.4	52.3	Acorn Capital Limited	83.9	7.4			
Depreciation/Amort	A\$m	(0.2)	(5.7)	(4.0)	(18.5)						
EBIT	A\$m	11.2	(2.7)	16.4	33.8						
Net Interest	A\$m	1.5	1.8	1.9	2.3						
Pre-Tax Profit	A\$m	12.7	(0.9)	18.4	36.1						
Tax Expense	A\$m	(0.2)	(3.6)	-	-						
NPAT	A\$m	12.5	(4.5)	18.4	36.1						
Abnormal Items	A\$m	(4.2)	19.2	-	-						
Reported Profit	A\$m	8.3	14.7	18.4	36.1						
Financial Position						Reserves					
	Unit	FY2011A	FY2012F	FY2013F	FY2014F		Unit	1P	2P		
Cash	A\$m	33.2	27.6	43.0	45.1	as at Sept 2011					
Other Current Assets	A\$m	0.3	5.5	5.5	5.5	Galoc	mmbbl	1.15	1.89		
Total Current Assets	A\$m	33.5	33.2	48.5	50.6	Total	mmboe	1.15	1.89		
Property, Plant & Equip.	A\$m	0.7	47.5	44.3	70.6	Contingent Resources					
Exploration	A\$m	12.9	11.3	14.5	15.3	as at May 2011					
Investments/other	A\$m	19.1	2.8	2.8	2.8	Galoc	mmbbl		1.49		
Tot Non-Curr. Assets	A\$m	32.6	61.6	61.6	88.7	Total	mmboe		1.49		
Total Assets	A\$m	66.1	94.8	110.1	139.3	Production Summary					
Short Term Borrowings	A\$m	0.0	0.0	0.0	0.0		Unit	FY2011A	FY2012F	FY2013F	FY2014F
Other	A\$m	4.4	14.6	14.4	14.5	*Attributable					
Total Curr. Liabilities	A\$m	4.4	14.6	14.4	14.5	Liquids	mmbbl	0.45	0.48	0.60	0.94
Long Term Borrowings	A\$m	-	-	-	-	Gas	bcf	0.20	-	-	-
Other	A\$m	0.1	0.1	0.1	0.1	Total	mmboe	0.48	0.48	0.60	0.94
Total Non-Curr. Liabil.	A\$m	0.1	0.1	0.1	0.1	Daily Production	boe/d	1,329	1,309	1,631	2,584
Total Liabilities	A\$m	4.5	14.7	14.5	14.6	Price Assumptions					
Net Assets	A\$m	61.6	80.1	95.6	124.6		Unit	CY2011	CY2012	CY2013	CY2014
Cashflow						Oil	US\$/bbl	104.22	102.68	103.37	99.02
	Unit	FY2011A	FY2012F	FY2013F	FY2014F	Exchange Rate	A\$/US\$	1.04	1.00	0.95	0.92
Operating Cashflow	A\$m	8.5	6.0	17.3	42.6	Hedging					
Income Tax Paid	A\$m	0.0	(6.0)	-	-		Unit	FY2011A	FY2012F	FY2013F	FY2014F
Interest & Other	A\$m	(0.0)	(0.0)	1.9	2.3	Total Forward Sales - Oil	mmbbl	-	-	-	-
Operating Activities	A\$m	8.5	0.0	19.2	44.9	Forward Oil Price	A\$/bbl	-	-	-	-
Property, Plant & Equip.	A\$m	(0.8)	(0.6)	(3.3)	(41.5)	Sensitivity Analysis					
Exploration/Development	A\$m	(12.2)	-	(3.3)	(4.0)		Valuation (\$/s)	NPAT	EPS (c)	CFPS (c)	
Investments	A\$m	4.4	(8.9)	-	-	Base Case	0.28	-4.5	-0.4	0.0	
Investment Activities	A\$m	(4.3)	(7.1)	(6.6)	(45.5)	Exchange Rate +10%	0.27	26.6	2.3	2.1	
Draw/Repay Borrowings	A\$m	(0.0)	-	-	-	Exchange Rate -10%	0.27	30.3	2.7	2.3	
Equity	A\$m	2.7	-	2.8	2.7	Oil Price +10%	0.27	27.4	2.4	2.1	
Financing Activities	A\$m	3.0	4.0	5.0	6.0	Oil Price -10%	0.27	25.7	2.3	2.1	
Net Cashflow	A\$m	6.9	(7.0)	15.3	2.1	*N.B. NPAT, EPS, CFPS forecasts are for FY2012					
Ratio Analysis						Share Price Valuation (NAV)					
	Unit	FY2011A	FY2012F	FY2013F	FY2014F		\$m	\$/share			
Cashflow Per Share	A¢	0.7	0.0	1.7	3.8	Galoc (NPV @ 10%)		90.0	0.08		
Cashflow Multiple	X	11.2	2019.5	5.0	2.2	Exploration		230.3	0.20		
Earnings Per Share	A¢	1.1	(0.4)	1.6	3.1	Cash		29.5	0.03		
Price to Earnings Ratio	X	7.7	(21.2)	5.3	2.7	Corporate Overheads		(28.9)	(0.02)		
Dividends Per Share	A¢	-	-	-	-	Total Debt		0.0	0.00		
Dividend Yield	%	-	-	-	-	Tax Losses		0.0	0.00		
Interest Cover	X	na	1.5	na	na	Options & Other Equity		8.3	0.01		
Return on Equity	%	13%	18%	19%	29%	Total		329.2	0.28		
Analyst: Peter Gray						Last Updated: 24/07/2012					
Phone: +61 8 9268 2837											
Sources: IRESS, Company Information, Hartleys Research											

Fig. 1: Key assumptions and risks for valuation

Assumption	Risk of not realising assumption	Downside risk to valuation if assumption is incorrect	Comment
Phase 2 development at Galoc is successful	Moderate	High	Our Galoc valuation assumes that Phase 2 development is undertaken. Further, we assume that flow rates from two new wells will reflect the better historic flow rates. We have a value of \$42m to Otto if Phase 2 was not undertaken, however, this value will be much lower if Phase 2 is undertaken but is subsequently unsuccessful.
The long term oil price is approximately US\$84	High	Moderate	We use a declining forecast oil price that peaks at US\$107 and declines to US\$93 by 2017 (AUD peaks at 1.07 and declines to 0.91). Our forecasts are based on market consensus but actual future prices could vary materially up or down from estimates used.
The market will recognise exploration value before results are known	Moderate	High	Our exploration valuation includes a risked metric based on prospect size for permits or wells held by the Company. In essence, exploration values assume that the market will recognise a portion of potential value before the results of a well are known. In most cases, we include just 10% of potential prospect value in our valuations. However, this may increase or decrease depending on the type of well being drilled and confidence in the prospect.

Conclusion

We believe the largest risk to our valuation is disappointment at Cinco.

Source: Hartleys

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a “Buy”. Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a “Buy”.
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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