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Ophir Energy: Santos assets set to drive significant growth

A special report from ValueTheMarkets.com

Fortuna Misfortune

Thanks to numerous delays and a significant write-down related to its Fortuna development, shares in Ophir Energy (LSE:OPHR) have faced a drubbing this year, falling from highs of 76p in January to their current 42p. In its eagerness to dismiss the firm, the market appears to have given no credence to the business's game-changing purchase of a basket of Asian assets for $205m back in May. With the deal pushing anticipated turnover to more than £160m for 2018 alone- with plenty of upside potential and institutional support to boot- Ophir's current £297m valuation could represent a great buying opportunity.

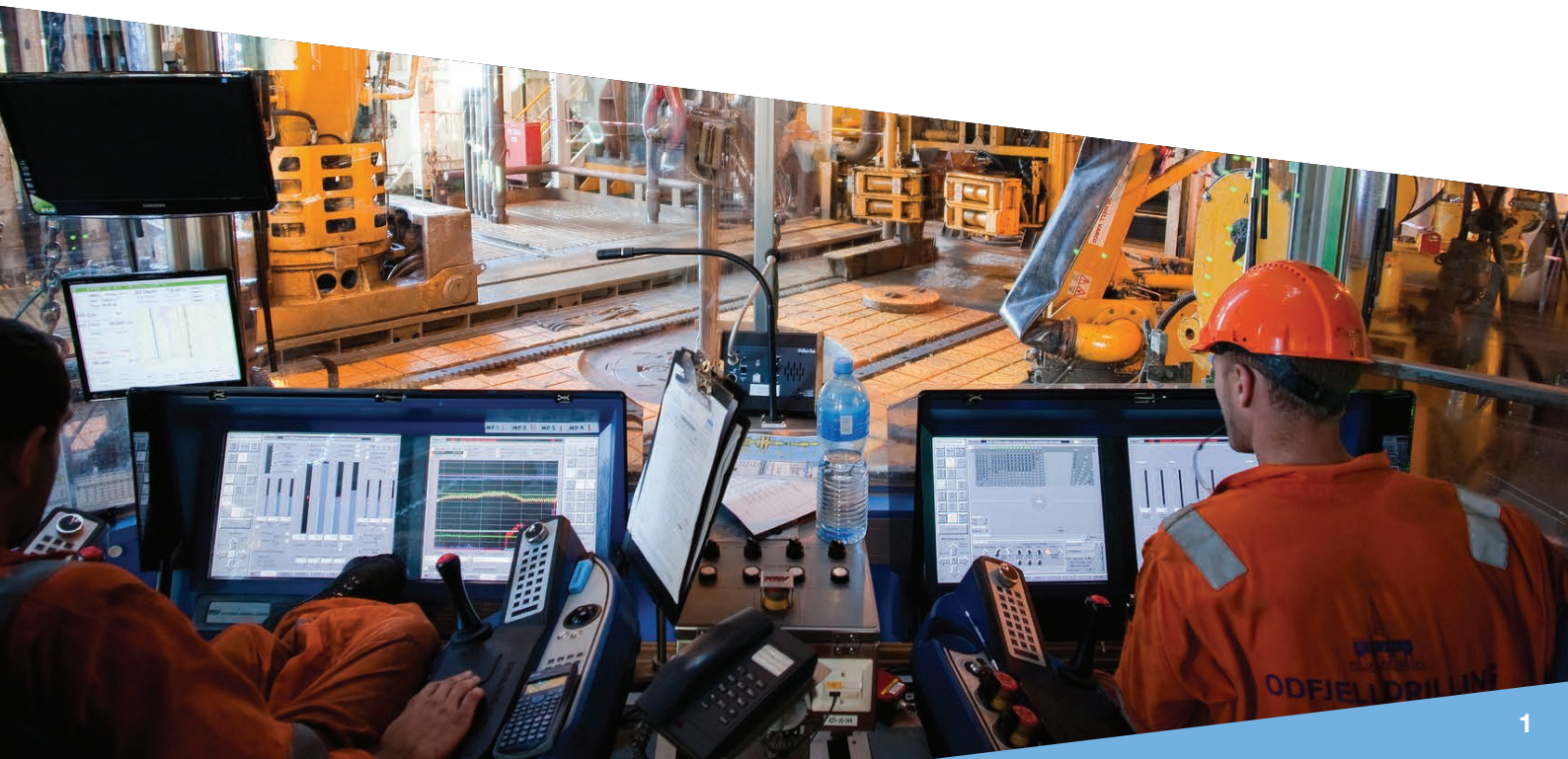
Ophir's steep decline this year has mainly stemmed from problems at its Fortuna development. The site was expected to be Africa's first deepwater independent floating liquefied natural gas project (FLNG), with anticipated production of 2.2MMtpa. However, unfortunately for 80pc-owner Ophir, funding has proved harder than expected to come by.

Development funds were initially expected to be sourced last year from a group of Chinese banks. However, in November last year, Ophir said it was pursuing alternative arrangements because this avenue was taking longer than expected. Then, in December, Ophir told the market that discussions with an Asian bank for $1.2bn of funding were at an advanced stage, but would have to continue into 2018.

By May this year, Fortuna's financing had still not been secured. In an update that month, Ophir said it was still engaged in senior level discussions with several counterparties, but suffered a major blow after revealing that Schlumberger had decided to leave the project. The oil services major had been a driving force behind OneLNG, a JV with Golar and Ophir that had been steering Fortuna's funding talks.

Fortuna's prospect darkened even further in July when Ophir warned that the project's licences expire at the end of this year. Things finally reached a head in September, when the company impaired Fortuna's value by $310m to $300m in its half-year results. Ophir said it made the move after deciding it was uncertain whether it could deliver value from the asset before the expiry of its licence. It added that a further impairment may be required on Fortuna, depending on the outcome of development discussions.

As things stand it seems probable Ophir could write down the entire value of the project.



Moving On

By focusing entirely on Fortuna's troubles, investors may have missed some of the considerable progress Ophir has made over 2018 in other areas of its business.

From a management perspective, former CEO Nick Cooper left in May, with non-executive director Alan Booth taking over his role on a temporary basis. The firm decided to hire a new CEO to reflect a strategic re-alignment that has seen it 'rebalance its portfolio towards a larger production and cash flow base to support more focused and sustainable exploration activity'.

Ophir elaborated on this strategic change further last month, adding that it plans to minimise its exposure to frontier exploration. It also hopes the new focus will enable further economies of scale in operating and administrative expenditures while providing greater capital allocation and financing efficiencies. Meanwhile, the search for a new CEO continues.

As part of this new focus, Ophir announced plans to buy a package of SE Asian assets from Australian firm Santos in May. The $205m purchase closed last month and includes 'material producing' assets in Vietnam and Indonesia plus exploration and appraisal assets in Malaysia, Vietnam, and Bangladesh, the purchase of which are expected to be finalised next year.

When it announced the acquisition, Ophir said the assets would increase 2P reserves by more than 40pc to 70.6MMboe. It also said it would provide plenty of upside potential due to the full-cycle opportunities in Vietnam, Indonesia, and Bangladesh. Finally, the business said it would bring forward its long-term objective of becoming free cash flow positive, which, in turn, would allow it to look at returning capital to shareholders.

Map of Santos Asian Assets

Source: Ophir Energy Prospectus August 2018

Shrewd Operator

Despite the clear significance of the Santos acquisition, Ophir's shares sat utterly flat at 59.4p on the day it announced the deal. Since then the deal has gone on to look even more attractive, making the ongoing lack of positive corresponding movement in Ophir's share price appear all-the-more baffling.

Upon announcing the acquisition, Ophir said the Santos assets would provide it with proforma production of 13,500boepd. This contribution was expected to take group proforma 2018 production to 25,000boepd while doubling 2018 forecast funds flow from production to c.$180m (£138.7m).

As if these figures were not already strong enough, in its half-year results, Ophir went on to announce that production from the Santos assets had been much higher than predicted so far this year. Indeed, it said production from the Vietnamese fields had averaged 9,200boepd net to Ophir, while net output from Indonesia had averaged 9,300boepd, a net total of roughly 18,500boped across all the Santos assets.

In line with this, the business also revised its group proforma 2018 production up to 27,500boepd, while net funds flow from production rose to $210m (£161.9m). This really is a massive amount of turnover for a business with a current market cap of just £296.7m.

What's more, at current commodity prices and after budgeted investment programmes, Ophir expects its production base to generate free cash flow of $300 million over the next three years. These funds could be pumped into additional acquisitions, developments, or even dividends, creating further value for shareholders.

And there could be more to come. In August's prospectus for the Santos deal, Ophir revealed that, based on its mid-case long-term oil price projection of $60/bbl, the 2P reserves of the Santos assets have a forecast NPV(10) of $246m. Converted to Sterling and this equates to £187m, which compares favourably to Ophir's current market valuation of £300m. On the company's more bullish assumption of $70/bbl long-term oil prices – more in line with current Brent prices – the assets have an impressive 2P NPV(10) of $270m, or £205.5m.

Summary of NPVs for Santos Assets 01 July 2018[2]

NPV US$ million	$54/Barrel Long Term			$60/Barrel Long Term			$70/Barrel Long Term		
Asset	**1P**	**2P**	**3P**	**1P**	**2P**	**3P**	**1P**	**2P**	**3P**
Madura	$9	$19	$28	$9	$19	$28	$9	$19	$28
Sampang	$11	$15	$22	$11	$15	$22	$11	$15	$22
Indonesia	**$20**	**$34**	**$50**	**$20**	**$34**	**$50**	**$20**	**$34**	**$50**
Chim Sáo	$118	$155	$185	$170	$212	$269	$187	$236	$307
Vietnam	**$118**	**$155**	**$185**	**$170**	**$212**	**$269**	**$187**	**$236**	**$307**
Total NPV	**$138**	**$189**	**$235**	**$190**	**$246**	**$318**	**$207**	**$270**	**$356**

[2]Note: Historic costs before 1 January 2018 are considered sunk (Effective Date) but are used in calculations for tax calculations and future tax payments. The valuation of cash flow is value at 1 July 2018. Cashflows between 1 January 2018 and 30 June 2018 are escalated to Valuation Date of 1 July 2018 at 10%.

Source: Ophir Energy Prospectus August 2018

While this sort of cash flow generation looks extremely attractive, this is still somewhat tempered by the looming risk of a further Fortuna write-down when the company comes to announce its full-year results. However, this is where another attractive element of the Santos deal becomes clear.

Ophir have structured the Santos deal to be effective from 1 January this year, meaning that – on a proforma basis – the company will receive the full financial benefit and production uplift of the transaction throughout the whole of 2018.

Rather cleverly, the firm did not complete the deal until last month, meaning it did not include this added production and turnover in its half-year results.

Indeed, over H1 2018, it published output of 11,400boepd, and $43m of net funds flow from production.

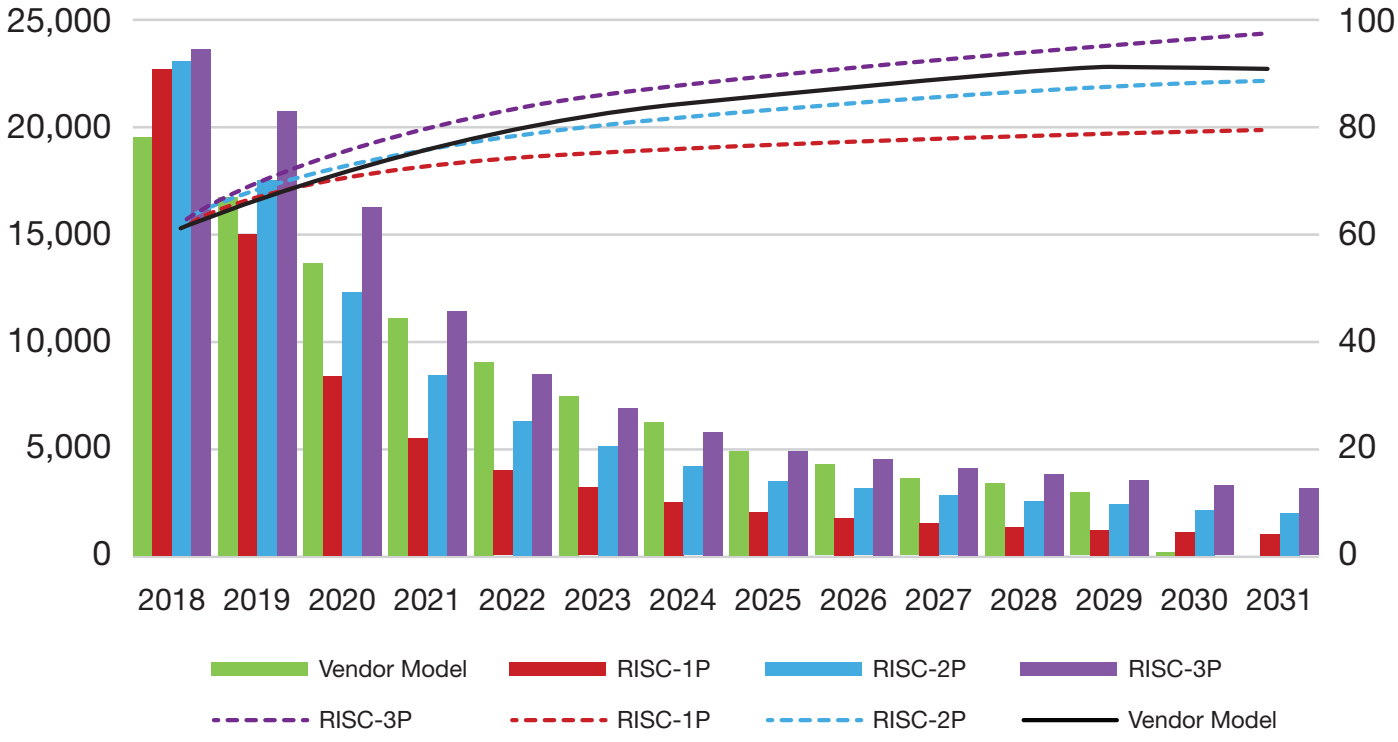
Essentially, by doing this, Ophir could get two (and possibly even three) bites of the cherry. Firstly, it was able to soften the blow of the first Fortuna write-down by announcing that the Santos deal had completed and was performing ahead of expectations just one week before its H1 results were released. Second, when it posts full-year results next year, it will be able to report a significant increase in H2 production and revenues thanks to the inclusion of Santos production from September to December. Once again, this will soften the blow of any additional Fortuna write-downs. Third, if it turns out that Ophir's production forecast for the year has been conservative and Brent continues to trade at the high end of the company's model then its final results could get a further boost.

Upside Potential

As positive as the Santos deal looks for Ophir, there are some other factors to be mindful of. One potential challenge is the late-stage position of the assets, with field life expected to last until 2028. Despite this, Ophir believes the Santos assets could host further development upside, which could take production beyond 25,000boepd.

Production is expected to start-up twelve months after a final investment decision and is expected to plateau at 25MMscfd for three years, before starting to decline. The development of Meliwis will also extend the economic life of the Maleo field in Madur, which will lead to monetisation of an additional 7.6Bcf of contingent resource, according to Ophir.

Base Case Oil Production Forecast RISC vs Vendor Model



Source: Ophir Energy Prospectus August 2018

One particular opportunity highlighted by the firm is the potential Meliwis field development on the ex-Santos Madura offshore production sharing contract.

A final investment decision will be made here in Q4 2018 and could convert 31Bcf of contingent gross resource into 2P reserves at a net cost of $54m.

City Backing

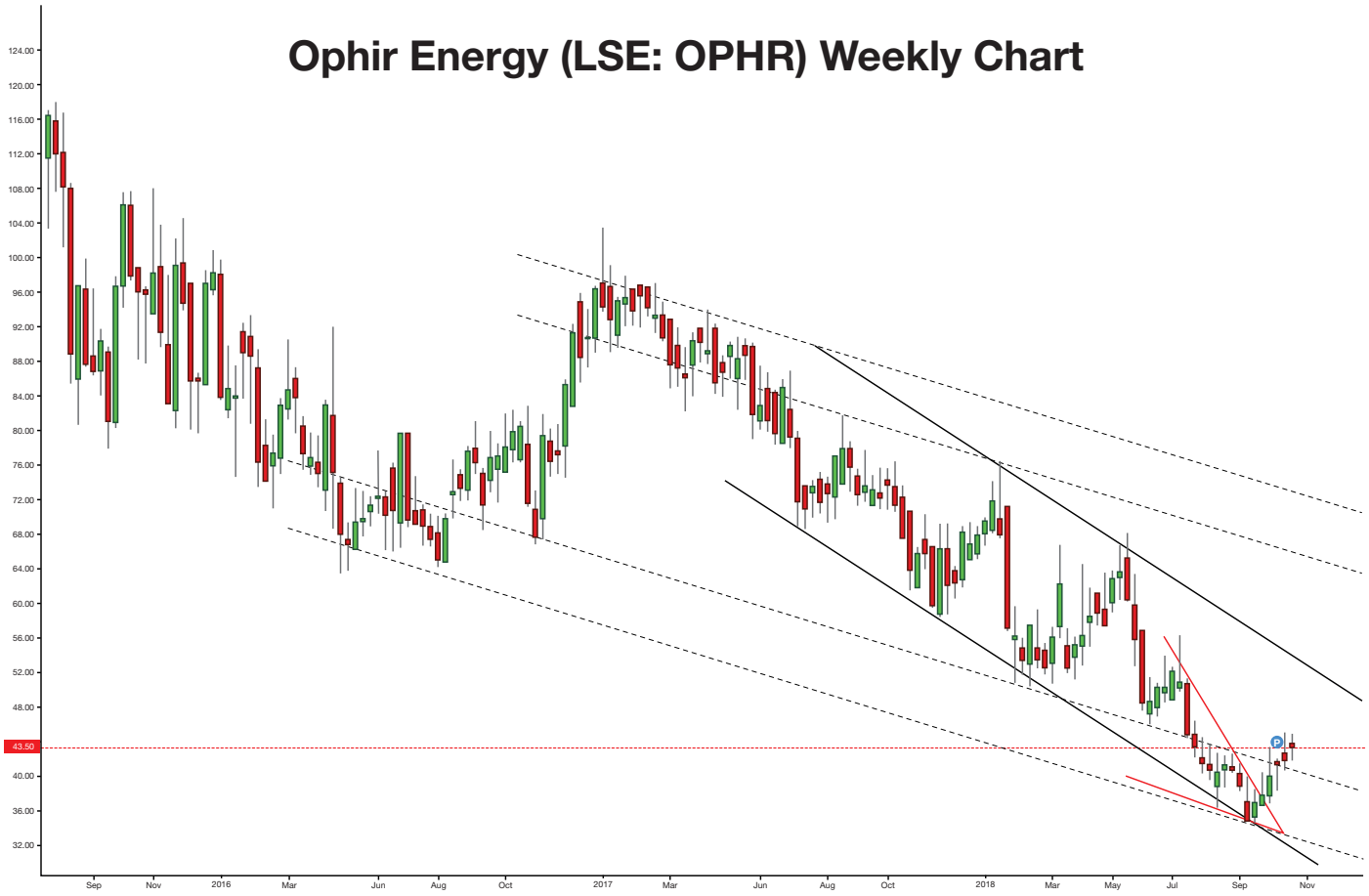
As noted, Ophir's updates at Santos have failed to grab the attention of the market since being announced. However, it is encouraging to see that the business appears to have attracted a strong support from institutional investors.

First of all, to pay for the acquisition of Santos assets, the business was able to utilise its existing financial resources alongside a new 18-month acquisition bridge facility of up to $130m. Ophir said it would subsequently refinance this bridge facility in its existing $250m reserve-based lending (RBL) facility.

RBL facilities are viewed favourably by the market because it means a lender has assessed the viability of a company's assets and is confident that it will be able to repay the money lent to it based on stable future cash flow generation. If Ophir can get its RBL provider to refinance and cover the cost of the Santos acquisition – as it believes it will be able to – then it will also show that the lender agrees with its assessment of the deal's potential.

Secondly, a look at Ophir's shareholder base shows that institutional investors accounted for nearly 50pc as at 28 February 2018, with big-name investors including M&G (9.79pc) and Majedie AM (4.97pc). A more current register is not available, but RNS holdings updates suggest that since this period, large city players Legal and General (5.2pc) and Standard Life Aberdeen (6.5pc) have built up considerable stakes in the business.

Finally, the last month or so has seen a number of Ophir's senior management team increase their stakes in the business to take advantage of weakness in its share price. On 14 September, chairman Bill Schrader purchased c. $30,000 worth of shares while on 18 September non-executive director David Davies bought around £50,000 worth.



Source: Investing.com

Can't See The Wood For The Trees

Putting aside the chance that the Fortuna project will be financed and progressed and assuming its licenses will expire at the end of 2018, there is no question that a write-down of up to $600m over the year would be a significant blow for Ophir. However, with its shares continuing to languish at multi-year lows, it seems the market is so focused on the impact of this hit that it has overlooked the business's attempts to move on. It is here that a potential buying opportunity could have arisen.

Indeed, with a market cap of just £296.7m, Ophir's valuation is underpinned by the mid case NPV(10) of £187m. Given that the company is fully funded to develop the Santos assets and this mid-case is based on a $60/brl Brent price the scope for upside is clear.

With further upside potential across the company's new portfolio and lenders, management, and institutional investors all demonstrating faith in the company's prospects, 42.8p looks attractive before any upcoming news might trigger a re-rate.

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