Tennyson

Europa Oil & Gas (EOG LN)

MARKET DATA

Bloomberg	ticker	EOG LN
Share price	p/shr	1.125
Target	p/shr	2.3
TP upside	%	104%
Shares out	Million	956.5
Fd shares	Million	987.3
Mkt cap	US$m	12.8
EV	US$m	8.2

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EMERALD GREEN

Europa Oil & Gas (EOG LN) recently announced that its application to extend the first phase of its Irish licence FEL 4/19, in the Slyne Basin off the West Coast has been granted, giving the Company an additional 14-months to progress the licence and secure a farm-in partner. We see this as a significant vote of confidence from the Department of the Environment, Climate and Communications (DECC) that the FEL 4/19 permit will play a vital role in the country's transition to a net zero society, and the recent extension suggests that DECC is on the same page. The extension was granted despite the Minister in charge of the department being a member of the country's Green Party (leading some to speculate that the industry was in its final throes). The good news counters the recent setback following disappointment with the Serenity appraisal well in the UK North Sea. The well failed to prove an extension of the discovery, meaning the partners will now look to draw up a more modest development plan for the c.18 mmbbls (gross) anticipated in place. Having adjusted for the results from the Serenity well, and allowed for a de-risking in Ireland, we cut our Total NAV to 12.3p/shr (down from 22.2p/shr). Our updated Target Price of 2.3p/shr remains firmly underpinned by the value of the 2P+2C resources at Wressle, and with nothing in the price for the Irish assets, Serenity, or onshore exploration, this provides ample opportunities for upgrades. On the back of weakness following the Serenity drill result, today's share price of 1.125p/shr offers over 100% upside to our target price, as such we reiterate our BUY recommendation.

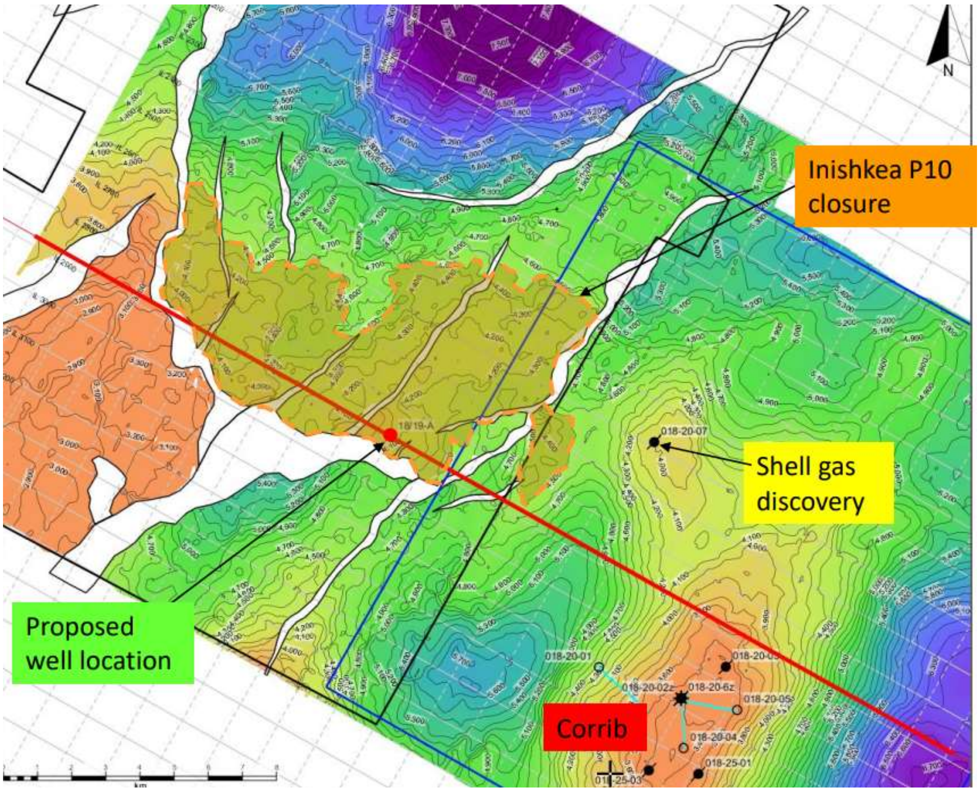
FEL 4/19

Europa's licence FEL 4/19 lies adjacent to Ireland's only domestic gas field, Corrib. The field has been in production since 2015, and has supplied up to 60% of the country's gas needs, however it is maturing (currently supplying around 30%), and without additional throughput could cease production by as early as 2026 or 2027. The energy crisis has naturally prompted governments to diversify reliance on imported gas, coinciding with a more nuanced approach to climate change and greenhouse gas emissions. This resulted in a meeting earlier this year between the Corrib partners and Taoiseach Michael Martin, during which a proposal was put forwards, amongst other things, to explore in existing licences adjacent to Corrib to extend the field life (https://www.independent.ie/irish-news/energy-crisis-corrib-gas-field-operator-tells-taoiseach-micheal-martin-they-can-extract-fuel-for-another-decade-41945944.html). From an ESG perspective, this has a number of advantages. Firstly, from a social point of view the field and its associated gas plant is a major local employer, supporting around 150 jobs directly and many other ancillary roles. Environmentally, the extension of field life would be particularly significant. A tie-back to existing infrastructure is effectively a brownfield development, with the majority of handling and processing infrastructure already in place. Local gas production would offset imported gas, which currently arrives into Ireland from the UK (ultimately from Norway, and LNG from the likes of USA and Qatar) via two pipelines. The carbon footprint of imported gas, particularly LNG which requires supercooling and shipping, is substantially higher than domestic gas, and therefore until renewable supplies meet demand levels Corrib is likely to supply the 'cleanest' gas, on top of the other benefits mentioned above. Furthermore, with the Irish government recently signing off on three new gas fuelled power stations in the Dublin area alone, we do not expect renewables to cover the country's total energy demand anytime soon.

To recap, Europa has a 100% interest in licence FEL 4/19, which includes the Corrib North gas discovery, made by Shell in 2010, and the 1 Tcf Inishkea exploration prospect (shown in Figure 1, below). While Corrib North was deemed uneconomic back in 2010, the new higher gas price environment is likely to have moved the discovered resource above the commerciality threshold, and studies are ongoing to mature the project to the point at which an investment decision can be made. Meanwhile Europa also continues to work up the Inishkea prospect in preparation for an exploration well. The company has merged and reprocessed two 3D seismic datasets, defining the size of the prospect at between 244 bcf and 3.6 Tcf, with a PMean of 1.5 Tcf.

The licence officially was due to expire on 31 July 2022 and despite Europa submitting a request for an extension in March, it was not until November that the extension was approved. This allows the company another 14 months to finalise plans for an exploration well and attract a farm in partner. Although it was late coming, the extension provides a significant vote of confidence in the project from DECC and the wider Irish government. It provides time for Europa to secure a partner, to assist in financing the c.£30m exploration well, and crucially provides comfort to any prospective partner that the government will support the project going forwards. In our view there are a number of prospective partners who are likely to show interest in farming in. Arguably the most natural buyers would be the existing Corrib partners (Vermillion Energy and Nephin Energy), however M&A activities with respect to gas developments in the UK North Sea are picking up strongly and we would not be surprised to see suiters drawn away from the UK by the relative value and material scale offered here.

Figure 1: Inishkea prospect and Corrib North discovery well



Source: Europa Oil & Gas

Wressle update

Wressle continues to perform ahead of expectations, with the field now having produced around a quarter of a million barrels of oil, with zero water cut to date. Production is currently around the 700-750 bopd (gross) mark, constrained by gas flaring regulations. A two-stage gas utilization scheme is underway, which will have the double bonus of monetizing the gas and allowing oil to flow at unconstrained rates. This could add an additional 50% to oil production, on top of the freshly monetized gas, resulting in gross oil plus gas rates more than doubling (to c. 900-1,300 bopd). Once the associated gas from the Ashover Grit is utilized, the gassier Penistone Flags reservoir can be tapped, which could add a further 250 boepd (predominantly gas) at peak.

Including Europa's other producing assets (West Firsby, Crosby Warren and Whisby), the company is currently delivering some 250 bopd net – equivalent to monthly sales of US$0.7m at today's oil price. Average netbacks are in the order of US$55/bbl at current oil prices, implying monthly field-level cash flow of around US$0.4m.

Serenity development options

The appraisal well at Serenity clearly disappointed, with the key risk – the presence of reservoir sands – proving its downfall. It appears that the sands encountered with the discovery wellbore pinch out to the West of the discovery well, resulting in an expected resource size of around 18 mmbbls STOIIP (around one tenth of what was hoped for prior to the appraisal well). Still, as a joint development alongside the neighbouring undeveloped Tain field, Serenity is likely to be commercial at current oil prices, and studies are underway to establish a conceptual development plan and confirm commerciality. It is possible that Serenity and Tain are connected, in which case the whole field would be unitised and developed as a single field, which could potentially improve the economics for EOG. The Serenity partners have until September 2024 to submit an FDP to the NSTA, or to agree an extension to the permit.

Value proposition and funding. At its current share price of 1.125p/shr, Europa's market cap is equivalent to under US$13m. The company is well capitalized – it has repaid the UJO loan facility, and with the Serenity well coming in £2m under budget (net to EOG), we estimate that the company currently has in the region of US$5.5m of cash (debt free) on the balance sheet, growing on a monthly basis. Europa's net share of the capex programme at Wressle is expected to total around US$0.5m over the next 12 months, and therefore can be comfortably funded with near term cash flow and existing resources.

UK focused E&Ps have come under the spotlight over the past few weeks due to the windfall profits tax hike, which saw Energy Profits Levy increased by 10% to 35%, taking the total marginal rate to 75%. We note however that this has little to no impact on Europa, thanks in no small part to its recent expense on the Serenity appraisal well, which provides shelter for the foreseeable future. Indeed, including further investment at Wressle, we don't expect Europa to pay any material tax, certainly not before 2028 based on current oil prices.

After adjusting for current net cash, our US$6.5m EBITDA forecast for FY23 (Jul '22-Jul '23) places the company on an EV/EBITDA multiple of just 1.3x – making the company look highly attractive based on current cash flow metrics alone. Until we see development plans for Serenity and FEL 4/19, we include these assets in our Total NAV (non-Core), with chances of success of 25% each. As before, our Target Price of 2.3p/shr is set at risked Core NAV, leaving plenty of scope for upgrades as the non-core assets are matured.

Our full valuation table and cash flow forecasts follow on the next two pages.

Figure 2: Valuation summary table

NET ASSET VALUE									
Asset	**Gross**		**Net**		**Unrisked**			**Risked**	
	mmboe	**Interest**	**mmboe**	**US$/boe**	**US$m**	**p/shr**	**CoS**	**US$m**	**p/shr**
Onshore 2P	1.00	52%	0.52	15.0	8	0.7	100%	8	0.7
Onshore 2C	4.63	27%	1.23	15.0	18	1.6	75%	14	1.2
Add: net cash					5	0.4		5	0.4
Add: corporate items					0.5	0.0		0	0.0
Core NAV			**1.8**		**31**	**2.7**		**27**	**2.3**
Serenity	6.7	25%	1.7	15.0	25	2.1	25%	6	0.5
Onshore P50	34.5	33%	11.4	11.25	128	10.9	25%	32	2.7
Inishkea (Ireland)	266	100%	266.2	2.00	532	45.3	15%	80	6.8
Total NAV			**281.0**		**717**	**61.0**		**145**	**12.3**

Valuation assumptions:

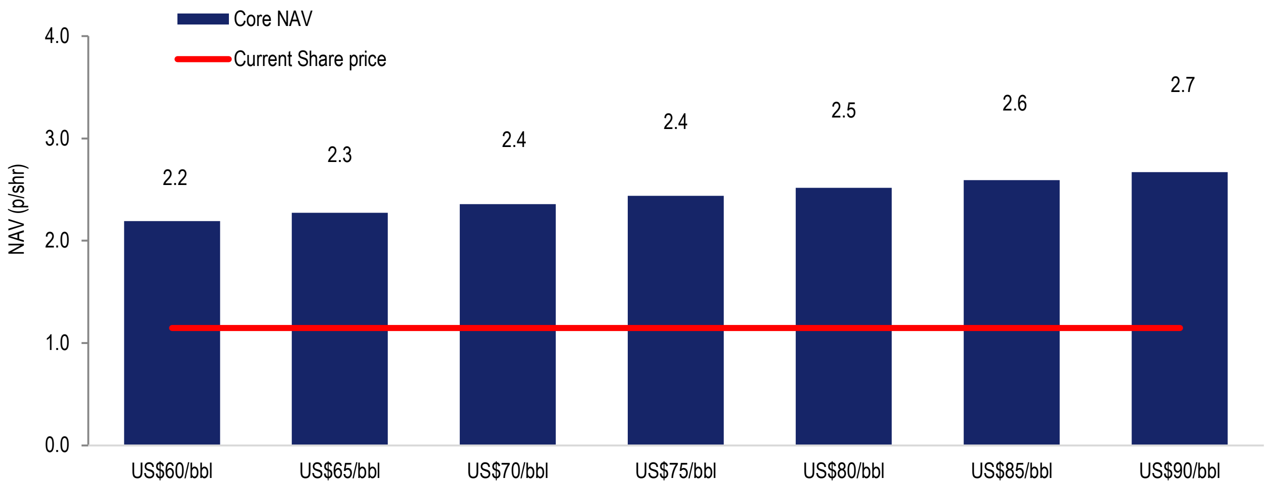
Brent price: US$93.9/bbl YE Jul 2023, US$82.6/bbl 2024, US$77.5/bbl 2025, US$70.3/bbl 2026, US$65/bbl flat thereafter.

Discount rate 10%.

1.19 US dollar / sterling.

956.5m ordinary shares outstanding. 30.56m options and warrants outstanding with exercise prices 1.23p-6.2p/shr.

Oil price sensitivity – Core NAV at various flat Brent prices (2025 onwards):



Source: Tennyson Securities.

Figure 8: Financial summary – P&L, cash flow and balance sheet

FYE 31ST JUN		2021	2022	2023E	2024E	2025E
Net oil & gas production	**boepd**	93	245	**305**	**393**	**418**
Average realised price	US$/boe	57	96.9	95.9	100.7	88.7
Net gas volumes	mmscf/d	-	-	0.0	0.3	0.3
Gas revenue	**US$m**	**-**	-	**0.4**	**4.2**	**3.3**
Net oil volumes	bopd	93	245	300	338	363
Oil revenue	**US$m**	**1.9**	**8.7**	**10.3**	**10.2**	**10.3**
Revenue	**US$m**	**1.9**	**8.7**	**10.7**	**14.4**	**13.5**
Operating costs	US$m	(1.6)	(2.9)	(3.1)	(3.3)	(3.3)
Unit	*US$/boe*	*(46.3)*	(32.2)	*(28.0)*	*(23.0)*	*(21.9)*
G&A costs	US$m	(1.0)	(1.1)	(1.1)	(1.1)	(1.1)
Unit	*US$/boe*	*(29.1)*	(12.1)	*(9.7)*	*(7.5)*	*(7.1)*
EBITDA	**US$m**	**(0.6)**	**4.7**	**6.5**	**10.1**	**9.1**
EBITDA margin	*US$/boe*	*(33.1%)*	54.3%	*60.7%*	*69.7%*	*67.3%*
DD&A	US$m	(0.1)	(2.9)	(2.7)	(3.4)	(3.6)
Finance and other expenses	US$m	(0.3)	0.0	(0.3)	(0.3)	(0.3)
Profit before tax	**US$m**	**(1.1)**	**1.8**	**3.5**	**6.3**	**5.2**
Income tax	US$m	0.2	(0.0)	-	-	-
Net income	**US$m**	**(0.9)**	**1.8**	**3.5**	**6.3**	**5.2**
Adjusted EPS (fully diluted)	c/shr	*(0.1)*	0.2	*0.4*	*0.6*	*0.5*
Profit before tax	**US$m**	**(1.1)**	**1.8**	**3.5**	**6.3**	**5.2**
Cash flow reconciliation	US$m	0.4	3.3	3.0	3.7	4.0
Working capital movements	US$m	(0.3)	(1.8)	-	-	-
Interest, net	US$m	0.0	-	-	-	-
Tax paid	US$m	-	(0.0)	-	-	-
Net operating cash flow	**US$m**	**(1.0)**	**3.3**	**6.5**	**10.1**	**9.1**
Cash flow margin	*US$/boe*	*(30.4)*	36.7	*58.4*	*70.4*	*59.9*
Capex	US$m	(1.4)	(2.2)	(6.7)	(3.5)	-
Free cash flow	**US$m**	**(2.4)**	**1.1**	**(0.2)**	**6.6**	**9.1**
Acquisitions/divestments	US$m	-	-	-	-	-
Debt movement, other	US$m	-	(8.8)	8.7	-	-
Share issuance	US$m	2.0	8.7	-	-	-
Net increase (decrease) in cash	**US$m**	**(0.4)**	**1.1**	**8.6**	**6.6**	**9.1**
Cash	US$m	1.2	10.9	10.2	16.8	25.9
Other current assets	US$m	0.7	2.5	2.5	2.5	2.5
O&G assets	US$m	9.4	9.0	13.0	13.1	9.4
Total assets	**US$m**	**11.3**	**22.3**	**25.7**	**32.3**	**37.8**
Debt	US$m	0.1	-	-	-	-
Other liabilities & decommissioning	US$m	6.8	7.6	7.4	7.7	8.0
Shareholder equity	US$m	4.5	14.8	18.3	24.7	29.9
Total equity & liabilities	**US$m**	**11.4**	**22.3**	**25.7**	**32.4**	**37.8**
P/E - adjusted, fd	*x*	-	-	*3.6x*	*2.0x*	*2.5x*
EV/EBITDAX	*x*	-	-	*1.3x*	*0.3x*	*(0.4x)*
FCF yield	*%*	-	-	*(1.2%)*	*51.4%*	*71.2%*

Source: Tennyson Securities.

DISCLAIMER

RECOMMENDATIONS HISTORY

Market index: **AIM ALL SHARE ENERGY**

Date	Market Index level	Share Price (p)	Target Price (p)	Opinion
09 Jun 2022	1462.2	2.5	7.8	BUY
24 Nov 2022	1005.1	1.125	2.3	BUY

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BUY: The stock is expected to generate absolute positive price performance of over 10% during the next 12 months.

HOLD: The stock is expected to generate absolute price performance of between negative 10% and positive 10% during the next 12 months.

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