EDISON

Petrel Energy

Update

Not wanting the Pampas to grow under its feet

Oil & gas

Petrel has consistently raised small amounts of capital and strategically used this to achieve a stated objective and deliver on its promises. The position it has built up in Uruguay, from a conventional and unconventional standpoint, is testament to the management. However, the current macro environment for commodities means that a lot depends on the farm-down of Uruguay.

Year end	Revenue (A$m)	EBITDA (A$m)	PBT* (A$m)	Net cash/(debt) (A$m)	Capex (A$m)
06/13	0.6	(6.9)	(7.0)	8.7	(3.7)
06/14	0.2	(3.0)	(3.0)	7.4	(2.5)
06/15e	0.0	(5.3)	(5.5)	0.7	(7.3)
06/16e	0.0	(1.4)	(1.7)	(0.2)	(1.0)

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Funds remain key

Petrel has just concluded a A$1m fundraising and is currently undertaking a share purchase plan for existing subscribers (concluding at the end of August). With A$1.1m of pre-fund-raising cash on its balance sheet at 30 June, these new funds will cover CY Q315 spending and provide funds into 2016. However, the focus needs to be on gaining a farm-in partner for Uruguay and Petrel has appointed Royal Bank of Canada to undertake a formal process, following receipt of a number of unsolicited approaches.

Other assets sidelined

We note that activities to farm-down the Spanish assets continue to be held up by red tape around the approval of a new well, the Tesorillo-1. The appraisal of the historic core sample and subsequent reanalysis has led to a downgrade of gas-in-place volumes but confidence in these estimates has improved, which should strengthen the farm-out case. An improving macro view of the European economic climate coupled with the prospect being exceptionally close to major European gas lines, means the asset is more likely to have potential if a deal is done. However, uncertainty around drilling means the assets on which we have based our RENAV have been removed, as per our research guidelines.

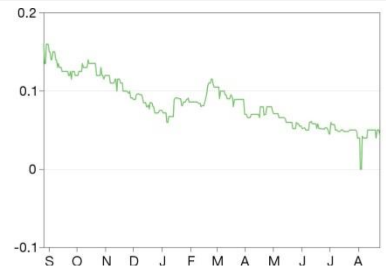
Valuation: Uruguay the focus

Uruguay offers large-scale, long-term unconventional upside and critically a number of relatively shallow conventional targets, one of which has been established as a prospect with 10.7mmbbl of P90 to 65mmbbl at the P10 prospective resource levels. A full or substantially carried farm-out is required to develop these prospects – either together, or with the deeper concessions farmed out and the shallower prospectivity initially developed in house. We are hopeful management will be able to execute as they have before, and there is a real opportunity for a cash-rich major or independent to secure an entry position in an untapped province, where a lot of ground work has been done. On the other hand, Petrel runs a real risk of being a cheap takeout candidate.

26 August 2015

Price	**A$0.05**
Market cap	**A$24m**
	US$0.75/A$
Cash (A$m) at 30 June 2015	1.1
Shares in issue	481.74m
Free float	69%
Code	PRL
Primary exchange	ASX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(4.0)	(7.7)	(70.0)
Rel (local)	3.7	2.6	(67.1)
52-week high/low		A$0.21	A$0.05

Business description

Petrel Energy is an ASX-listed business with declared prospective resources on assets in Uruguay, where there is potential for company-making conventional and unconventional discoveries. Farm-out activities have commenced.

Next event

Uruguay farm-out	Q315

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Edison profile page

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Activities update

Petrel has managed the progress in Uruguay well by taking definite but focused steps in proving up the presence of not only a potentially highly prospective conventional development, but also a large unconventional play. The continuing decline in oil prices and the sporadic need for cash by junior E&Ps has meant Petrel has undertaken a number of small fundraisings to continue the development of the opportunity. However, it has set itself apart from many in its space, by delivering on promises and not holding large amounts of capital. Despite this the shares have suffered – we see this as more of a symptom of the wider market than due to this strategy and should not detract investors from a significant opportunity, subject to a farm-out .

Uruguay developments

As described in our previous notes, Petrel has methodically undertaken core holes and an extensive 597km 2D program to delineate the resource potential of its two concessions onshore Uruguay, the Piedra Sola and Salto, covering approximately 3.5m acres.

Following the interpretation of the seismic data early in 2015, the company has identified geological structures and a previously unknown deeper basin in the Salto area, a Devonian and possible source rock section across both intervals. The Devonian is a particular interest given the activities AIM-listed President Energy is undertaking in the Pirity Basin, Paraguay.

Encouragingly, and also from a more immediate time frame for investors, Petrel has identified 20 conventional, shallower targets which could be relatively easily explored and monetised if shown to be commercial.

In May 2015, the independent prospective resource certification from Netherland, Sewell and Associates (NSAI) was updated, estimating an unrisked gross prospective resource in the two concessions of 910mmbbl of oil and 3.1tcf of gas

Exhibit 1: Net unrisked prospective resources

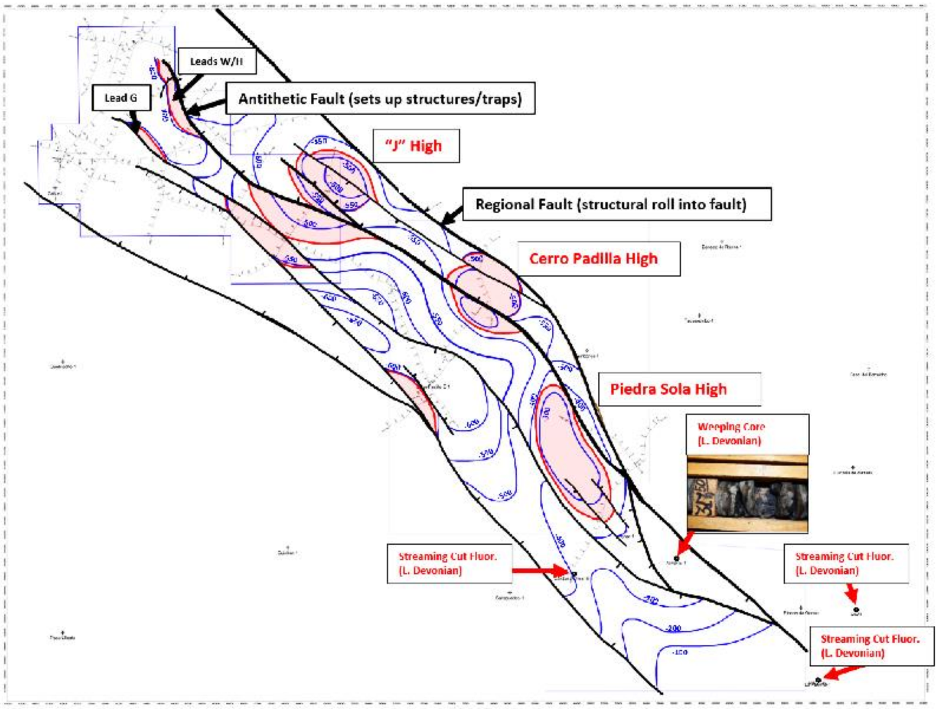
	Prospective resource (mmbbl)		OOIP (mmbbl)	
	Oil (mmbbl)	Gas (bcf)	Oil (mmbbl)	Gas (bcf)
Low (P90)	75	293	285	456
Best (median) P50	206	751	719	1,161
High (P10)	464	1,583	1,475	2,412

Source: Petrel Energy

The result of this ongoing assessment has been the identification of the first prospect within these 20 leads. The somewhat ironically named, Lead B, in the Salto area, has been assessed as having 10.7mmbbl of P90 prospective resources to 65mmbbl at the P10 level. The ongoing work has also identified an older sedimentary sequence outside the quantitative analysis undertaken to date.

Off the back of this work (and as we expected from our previous notes on the company noting that it has received a number of unsolicited approaches), Petrel is now in a formal farm-out process and has engaged Royal Bank of Canada to assist.

Exhibit 2: Devonian structures within Petrel's acreage



Source: Petrel Energy

Spanish developments (less Quixotic)

The attempts to farm-out the gas play in Southern Spain are playing out slowly, but the risk profile continues to be clarified. The Tesorillio project, which contains the 1956 Almarchal discovery, resides with two contiguous licences covering 94,000 acres. Following the receipt of historic data and reassessment by SEI, Petrel and NSAI, comparison of newly acquired core data has reduced the uncertainty around in-place volumes and porosity.

The latest NSAI reclassified reserves have halved the in-place volume but due to greater certainty around the porosity, the P10 numbers have only reduced by a quarter. Irrespective, the resource numbers are still significant for a project that resides close to large export infrastructure and a ready market in Europe as economic activity appears to be returning in a sustained manner.

Exhibit 3: Reclassified Tesorillo resources

	Prospective resource (bcf)	OGIP (bcf)
Low (P90)	95	318
Best (median) P50	360	720
High (P10)	992	1,418

Source: NSAI

There remains continued red tape around the approval of the Tesorillo-1 well and while a number of parties remain engaged in discussing farm-in options, the approval process is delaying any firm commitments. As a result, the current joint venture is seeking to suspend activities and commitments until approval to drill is granted.

Clearly this is a frustration for the company but we feel there is no value reflected in the current share price for this project and as such, the likelihood of no expenditure is a positive and while a farm-out remains a matter of when rather than if, in our opinion, the delay allows management time to focus on Uruguay.

Canada

Activities remain on hold in Canada as well. We note the settlement of a long-running court case has meant Petrel has acquired an interest in 14 leases (for a sum of $2,200) and has aligned its interests alongside its partner Bernum Petroleum. An exercise to obtain expressions of interest for the acquisition of Bernum failed to attract any sensible offers; the tag-along-rights for Petrel to dispose of its interests are on hold. There remains minimal cash drain on this project, and in our view, like Spain, is not reflected in the share price.

Finances

Like many in the industry, Petrel remains susceptible to the vagaries of the challenging macro environment. However, as a pure explorer, Petrel has the advantage of not facing decisions about production costs and operational expenditure, nor do they have to consider how debt repayments may or may not be made. While this luxury is offset by running very lean cash balances and the need to revisit the market, capital resources are being focused on a potentially very lucrative development in Uruguay.

In late July, Petrel announced a completed placement raising A$1m at 4.5c a share and is offering a share purchase plan to allow existing subscribers to acquire up to A$15,000 each, which will close on 27 August 2015. This new cash, along with the balance of A$1.1m at 30 June 2015, will cover likely expenditure for the next two quarters. Without a farm-in in Uruguay, this hand-to-mouth existence may be set in for a while. However, we highlight again the material upside for Uruguay and the strategy the company has undertaken, small strategic fund raises with a clearly defined use of proceeds has meant the company has delivered on its promises. Wider market malaise and commodity price weakness are outside of the company's control.

Valuation

Our RENAV outlooks are based on an 18-month timeline for prospective drilling that can be funded and is likely to be undertaken. Unfortunately, the project timelines in Spain seem to be somewhat unclear at this juncture. In addition, the outlook timelines and funding position for drilling in Uruguay are unclear. The current funding position takes Petrel through to mid-2016 but we cannot provide a RENAV given a lack of funded activity. However, the prospective resources and potential in Uruguay cannot be ignored for the longer term, or if a farm-down is executed.

At a market capitalisation of A$20m (c US$14.8m) the acreage in Uruguay is valued at US$4.2/acre (net). Across the border in Argentina, where the geopolitical and operating environment is a far cry from the relative stability of Uruguay, deals in the US$5,000 –15,000/acre range have occurred. The TSX Gran Tierra/Madalena deal in mid-2014 saw 890,000 acres and c 3,000boepd change hands for US$63m or US$70.7/acre and while there is a production gap between this deal and Petrel, it goes to show the valuation gap could be rapidly closed, subject to exploration success. It should be highlighted that the Gran Tierra acreage is not as geologically optimal as Petrel's, given that seismic has shown Petrel's acreage to be at the core of the basin, whereas Gran Tierra's is more around the edges of the basin.

A farm-out will be a significant step in proving up the conventional assets and would provide a line in the sand for valuation. The upside from unconventional assets could be some years away, but no less important. Hopefully, the low industry price environment is seen as a positive for low-cost services rather than an impediment for potential partners. Currently, the greatest risk to shareholders may be that Petrel is exposed as a cheap acquisition.

Exhibit 4: Financial summary

A$000s	2013	2014	2015e	2016e
Year end 30 June	IFRS	IFRS	IFRS	IFRS
Revenue	631	199	0	0
Cost of Sales	0	0	0	0
Gross Profit	631	199	0	0
EBITDA	(6,902)	(3,013)	(5,328)	(1,373)
Operating Profit (before GW and except.)	(7,125)	(3,143)	(5,496)	(1,673)
Exceptionals	0	0	0	0
Goodwill and intangible amortisation	0	0	0	0
Operating Profit	(7,125)	(3,143)	(5,496)	(1,673)
Net foreign exchange gain/(loss)	26	145	32	32
Net Interest	166	103	16	8
Profit Before Tax (norm)	(6,959)	(3,040)	(5,480)	(1,665)
Profit Before Tax (FRS 3)	(6,933)	(2,895)	(5,449)	(1,634)
Tax	0	0	0	0
Profit After Tax (norm)	(6,959)	(3,040)	(5,480)	(1,665)
Profit After Tax (FRS 3)	(6,933)	(2,895)	(5,449)	(1,634)
Average Number of Shares Outstanding (m)	298	429	458	485
EPS - normalised (c)	(2.34)	(0.71)	(1.20)	(0.34)
EPS - FRS 3 (c)	(2.33)	(0.67)	(1.19)	(0.34)
Dividend per share (c)	0.0	0.0	0.0	0.0
Gross Margin (%)	100%	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A
BALANCE SHEET				
Fixed Assets	5,529	10,260	18,433	19,133
Intangible Assets	3,094	10,197	18,360	18,060
Tangible Assets	231	64	73	1,073
Investments	2,204	0	0	0
Current Assets	9,318	11,546	1,747	777
Stocks	64	0	0	0
Debtors	0	0	0	0
Cash	8,675	7,912	1,271	300
Other receivables	579	3,634	477	477
Current Liabilities	(721)	(1,539)	(1,683)	(1,683)
Creditors	(721)	(997)	(983)	(983)
Short term borrowings	0	(542)	(700)	(700)
Long Term Liabilities	0	0	0	0
Long term borrowings	0	0	0	0
Other long term liabilities	0	0	0	0
Net Assets	14,126	20,266	18,497	18,227
CASH FLOW				
Operating Cash Flow	(3,317)	(2,802)	(1,931)	(970)
Net Interest	0	0	0	0
Tax	0	0	0	0
Capex	(3,683)	(2,516)	(7,302)	(1,000)
Acquisitions/disposals	0	0	0	0
Financing	10,178	4,586	2,093	1,000
Other	(930)	0	0	0
Net Cash Flow	2,249	(732)	(7,140)	(970)
Opening net debt/(cash)	(6,426)	(8,675)	(7,370)	(729)
Other	0	(651)	0	0
Effect of foreign exchange rates	0	78	499	0
Closing net debt/(cash)	(8,675)	(7,370)	(729)	242

Source: Edison Investment Research, company accounts

EDISON

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