I3 ENERGY

01 SEPTEMBER 2020 12:09 GMT - PRODUCTION
01 SEPTEMBER 2020 12:09 GMT - DISSEMINATION

BUY

Bloomberg	ticker	I3E LN
Share price	p/shr	5.5
Target	p/shr	10.0
TP upside	%	82%
Shares out	Million	693.3
Fd shares	Million	841.1
Mkt cap	US$m	49.9
EV	US$m	73.1

Reap what others have sown

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INVESTMENT CASE

Harvesting Canadian cash flow

In a bold change of strategy, i3 Energy (i3E) has transformed itself into a consolidator of long life / low decline conventional production assets in Canada, with a view to offering shareholders a dependable and growing stream of dividends. In recent weeks, the group has negotiated the purchase of c.10 kboepd of light oil & gas production for a net consideration of US$28.5m, through a small corporate acquisition (TSX-listed Toscana Energy – c.1 kboepd), which is expected to complete in Q4 via a plan of arrangement, and a more sizeable asset level deal (Gain Energy – c.9 kboepd). Talks around these acquisitions started in Q1 2020 and were consummated right at the time global oil prices were in free fall, putting i3 in position to strike a hard bargain. Subsequently, the company sold off a small part of the Gain portfolio to a third party in a concurrent transaction on considerably higher multiples. Resultantly, the net deal metrics are particularly striking, with i3 paying just 1x forward 12-month EBITDA and under 0.5x our PV10 of the PDP reserves.

Figure 1: Pro-forma financial forecasts*

		2020E	2021E	2022E	2023E
Production, net	kboepd	2.5	9.0	9.1	9.1
Av. realisation	US$/boe	17.0	21.4	21.5	24.7
Revenue	US$m	15.2	70.5	71.5	82.4
EBITDA	US$m	(0.5)	27.1	27.8	37.2
Margin	%	(3%)	38%	39%	45%
FCF	US$m	-	14.6	15.3	26.2
FCF yield	%	-	29.3%	30.7%	52.4%
Dividend yield	%	-	8.9%	11.4%	16.9%
Net debt / EBITDA	x	-	0.9x	0.5x	0.1x
EV / EBITDA	x	-	2.7x	2.3x	1.4x

Sources: Mirabaud Securities. *Assumes deal completion end Q3 2020.

Under i3 ownership we see a significant opportunity to manage the production base more efficiently by combining the two portfolios and leveraging the operating platform acquired in the Toscana deal. Additionally, despite a large inventory of undeveloped well locations (PUDs), very little drilling activity has taken place in recent years due to vendor cash constraints. As such, i3 has inherited low risk development optionality (for free), which will help offset natural declines over time. Looking forward, i3's approach will be to sweat the PDP reserves for FCF, with a view to returning 20-30% to investors in dividends (FY21 yield 8.9%) and reinvesting the balance in a mix of organic and inorganic growth opportunities – depending on which offers the most attractive returns at the time.

Time-limited consolidation play

Even by oil industry standards, the Canadian oil patch has experienced a tough few years. Canada relies heavily on the US as an export outlet for its oil & gas production, with domestic demand running at a fraction of overall supply. On the back of rapid supply growth in the 2010s – driven by oil sands and shale – the country has become export (egress) constrained, leading to a supply glut and widening Canadian oil & gas price differentials versus US benchmarks. In response, the Province of Alberta introduced production curtailments for the largest oil producers in 2018, which are still in place today, awaiting the construction of new infrastructure and pipelines.

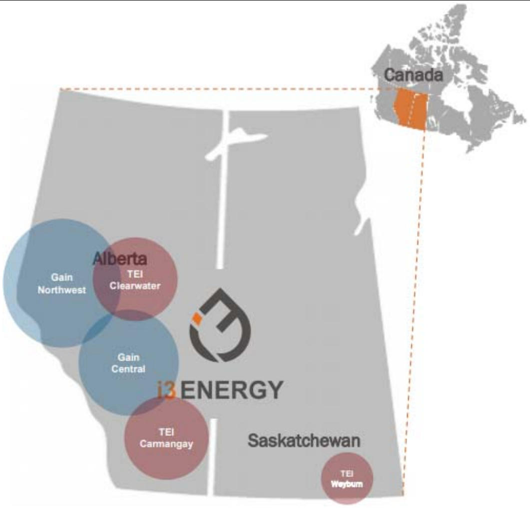
Amid uncertainty over egress, Canada's oil & gas sector has suffered from widespread underinvestment. Even before the recent oil price slump, M&A transactions had slowed to a trickle (<C$750m across seven transactions of between C$20-500m in 2019), amid a dearth of buying interest. Additionally, the industry has been running far too much leverage which has left swathes of companies in the hands of creditors (Toscana Energy is a case in point). The Canadian E&P sector is comprised of over a thousand private and publically listed producers, and i3 sees a time-limited opportunity to act as a consolidator, buying up proved producing assets at distressed valuations. Importantly, this opportunity arises at the same time as systemic egress issues are resolving themselves, with the completion of major infrastructure projects (2021-23), oil price-driven shut-ins and the normalisation of differentials.

Asset overview – diversified portfolio, long life, inexpensive drilling costs

The acquired assets are clustered across the provinces of Alberta and Saskatchewan in the Western Canadian Sedimentary Basin (WCSB), Canada's most prolific hydrocarbon region. The portfolio comprises ~470 net wells with >9.5 kboepd of production (43% oil & NGLs; 57% gas), spanning multiple fields and play types (mainly conventional). The vendor's reserve auditors, GLJ and Sproule, estimate aggregate PDP reserves of 20.5 mmboe. The majority of the producing wells are legacy vertical wells that have been onstream for years, with predicable long life / relatively low decline characteristics. In addition, the auditors estimate 2P reserves of 58.5 mmboe, implying 38 mmboe of undeveloped potential to exploit in time. Drilling costs vary, but are typically low (c.US$0.75m-US$5m each), with initial production rates averaging in the low hundreds of boepd (c.200-300 boepd).

The portfolio is highly FCF generative at current prices, thanks to modest lifting costs (averaging US$10-11/boe opex + royalty) and negligible maintenance capex in the PDP case (drilling & facilities costs are sunk). Oil price realisations are largely tied to Edmonton Light (currently c.US$4/bbl discount to WTI) – rather than Canada's better known heavy oil benchmark (WCS) – and gas to the Alberta (AECO) benchmark (currently a c.US$0.4/mmbtu discount to Henry Hub). Meanwhile, the PDP decommissioning liability is estimated at c.US$95m undiscounted (US$31m inflated at 2%, and discounted at 10%). Toscana adheres to the area-bound closure (ABC) Programme, whereby the company voluntarily retires 4% of its inactive well stock per annum. On closing of the two transactions, i3 expects to include the Gain assets in the programme, which would imply annual abandonment spend in the region of US$2-2.5m.

Figure 2: Canadian assets map



Operating stats	
Q4 2019 net Production (kboepd)	10,574
% liquids / % gas	43% / 57%
Total net wells (Op / Non Op))	360 / 107
Average working interest (% Op / Non Op)	82% / 14%
Audited reserves*	
PDP reserves (mmboe)	20.5
End of PDP reserve life	2068
2P reserves (mmboe)	58.5

Source: i3 Energy, Sproule. *GLJ and Sproule, FYE2019.

Alongside the upstream piece, the Canadian assets include processing and pipeline infrastructure, which provides export optionality (to ensure optimal marketing) and third party custom processing and tariff income (c.US$3-4m per annum).

i3's push into Canada will see its existing North Sea business unit become less of a focus. That said, the company retains 100% ownership of the promising Serenity oil discovery, which is potentially large and sits close to infrastructure – making it a prime candidate for a farm-out as industry conditions improve.

Value case - 29% FCF yield, 8.9% dividend & 0.23x P/NAV

Our financial forecasts assume i3 conducts a limited development programme holding group production flat at c.9 kboepd across the forecast period (FY20-23) – as shown in Figure 1, above. On this basis, we estimate US$14.6m of FCF after maintenance capex (at US$45/bbl Brent prices), implying a FCF yield of 29% and dividend yield of 8.9% (18% of pre-capex FCF). Looking beyond 2021, our estimated FCF and dividend yield increases to 31% and 11.4% in FY22 and 52.4% and 17% in FY23, largely driven by rising crude prices

(US$50/bbl FY22 & US$55/bbl FY23). Casting an eye across the listed UK E&P space we struggle to find an oil stock that looks more compelling on this basis.

Figure 3: i3 capitalisation and NAV

		PRE-DEAL	CHG	TODAY
Share price	p/shr	6.1		5.5
Market Cap	US$m	13.7	36.2	49.9
Net debt	US$m	32.1	(8.9)	23.2
EV	US$m	45.8	27.3	73.1
Total NAV	US$m			218.2
	p/shr			19.8
Market Cap / Total NAV	x			0.23

Sources: Mirabaud Securities.

On a DCF basis, we value the Developed Producing assets at US$76m (6.9p/shr), which, after adjusting for forecast net debt, results in a Core NAV of US$56m (5.1p/shr). This assumes a Brent price of US$45/bbl in FY21, ramping up in steps over FY22-24 to US$60/bbl long term. We attribute a further US$108m (9.8p/shr) of upside to the 2P reserve base, risked at 75%, which takes our 2P NAV to US$164m, or 14.9p/shr. On top of this, we value the legacy North Sea assets at a further US$54m (4.9p/shr), risked at 30%, resulting in a Total NAV of US$219m, or 19.8p/shr.

Our target price of 10.0p/shr is set conservatively at the mid-point between Core and 2P NAV. As i3 demonstrates success of its Canadian strategy, and/or succeeds in attracting industry investment in the North Sea assets, we will look to rebase our target price, attributing more value to the Canadian 2P reserve base and the North Sea. Still, given that the shares are currently trading around 5.5p/shr, our conservative target price offers over 80% upside to the current price, and therefore we initiate coverage with a BUY recommendation.

Risk factors

Whilst i3's Canadian expansion holds significant promise, we have identified three of the most pertinent risks to the stated business plan:

- Transaction risk: the Gain acquisition agreement, which represents the bulk of the acquired production and reserves, is subject to standard approvals and conditions, including ministerial approval. There is a risk, albeit small, that the transaction fails to complete (see Transaction & Funding section – page 6).
- Egress issues: Canada's oil industry has suffered from legacy infrastructure bottlenecks, due to an overreliance on US exports and rapid production growth in recent years. Thanks to new and planned export pipelines, this problem is steadily easing and domestic pricing has normalised.
- Acquisition strategy: building a business in a new geography through acquisitions carries inherent risks – including integrating new management, systems and operations. Furthermore, whilst i3 has carried out extensive due diligence (with the assistance of independent reserve consultants), a fuller understanding of the underlying assets will only be possible once i3 has assumed ownership.

TRANSACTION & FUNDING OVERVIEW

Building a platform for Canadian expansion

As part of a fresh investment drive i3 Energy has negotiated two production acquisitions in Canada for a net consideration of US$28.5m – comprising a mix of cash (US$28.2m) and 4.4m i3 shares (US$0.3m). The acquisition has three key components; the Toscana acquisition, the Gain Energy acquisition, and the Harvard sale of the Weyburn asset. The transactions were financed with an equity placing totalling c.US$38m, which also provides funds for near term development drilling (c.US$6.5m), for professional fees associated with the transaction, and for general working capital.

As discussed above, i3 has locked in attractive deal terms, against a backdrop of low oil prices and distress in the wider Canadian oil sector. A summary of the two acquisitions and deal metrics is shown in Figure 4, below.

Figure 4: Transaction overview

		TOSCANA	GAIN	HARVARD SALE	COMBINED
Transaction type		Corporate	Asset level	Asset level	
Headline consideration	US$m	2.8	58.8	-33.0	28.5
Effective date		15 Aug	1 May	1 May	
Closing date (estimated)		Q3 2020	Q3 2020	Q3 2020	
Production volumes (Q4 2019)	Kboepd	1,065	10,645	1,136	10,574
Percentage liquids (oil & NGLs)	%	62%	47%	100%	43%
EBITDA (12 months from close)*	US$m	2.7	28.6	-4.9	26.4
EV / EBITDA	x	1.0x	2.1x	6.7x	1.1x

Sources: i3 Energy. *i3 management estimates

Toscana Energy: i3 has exercised an option agreement to purchase Toscana Energy – a distressed TSX-listed E&P company – for an aggregate consideration of ~US$2.8m in cash and i3 shares.

- Under the agreement, i3 has already acquired Toscana's outstanding debt (totalling ~US$20m) for 12 cents in the dollar (costing ~US$2.5m – 50% paid upfront & 50% at year-end) and will issue 4.4m i3 shares (4% equity dilution at time of announcement) to Toscana shareholders.
- The key attraction of Toscana is it provides a platform for further regional growth, adding an experienced management team and operational capability that can be leveraged over future asset-level deals. In addition, it adds a secondary listing on the TSX for i3 with access to local capital markets.

Gain Energy acquisition: i3 has entered into a binding Purchase and Sale Agreement to acquire a much larger suite of assets from a consortium of Canadian pension funds for US$58.8 in cash.

- The Gain deal complements the Toscana transaction, adding scale to i3's Canadian operations and potential cost synergies – mainly in the form of lower unit G&A costs for the enlarged group. In addition, tax losses acquired with Toscana (US$94m) are expected to provide significant tax shelter for the Gain assets.
- The Gain assets are being acquired free of all encumbrances.

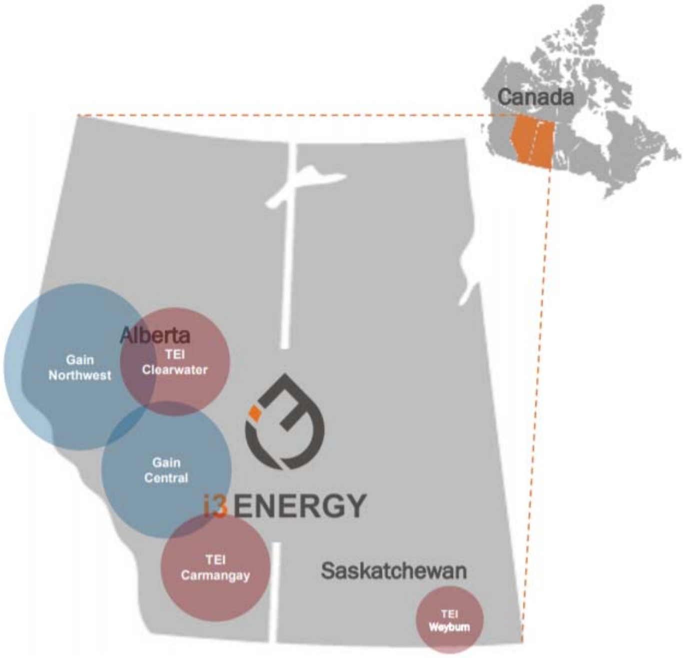
Harvard Energy asset sale: After negotiating the acquisition of the Gain Energy assets, i3 has reached an agreement with Canadian E&P Harvard Energy to onward sell Gain's c.5% interest in the Weyburn field for a cash consideration of US$33m.

- The consideration is paid directly to Gain Energy, and therefore reduces i3's share of the consideration to US$25.7m.
- The Harvard sale is conditional only on completion of the Gain Acquisition.

ASSET OVERVIEW: WESTERN CANADA SEDIMENTARY BASIN

Subject to the closure of the Toscana and Gain acquisitions, i3's Canadian assets will include a total of 467 net producing wells, across a number of fields, the majority of which are in the province of Alberta in Western Canada. (see Figure 5, below).

Figure 5: i3 Canadian portfolio



Source: i3 Energy

In total, i3 will produce in the region of 10,000 boepd net, comprising c.4,300 boepd of oil, condensate and NGLs (43%) and c.5,700 boepd of dry gas (57%). Net 2P reserves total approximately 59 mmboe, of which c.36% (21 mmboe) is classified as Proved Developed Producing (PDP).

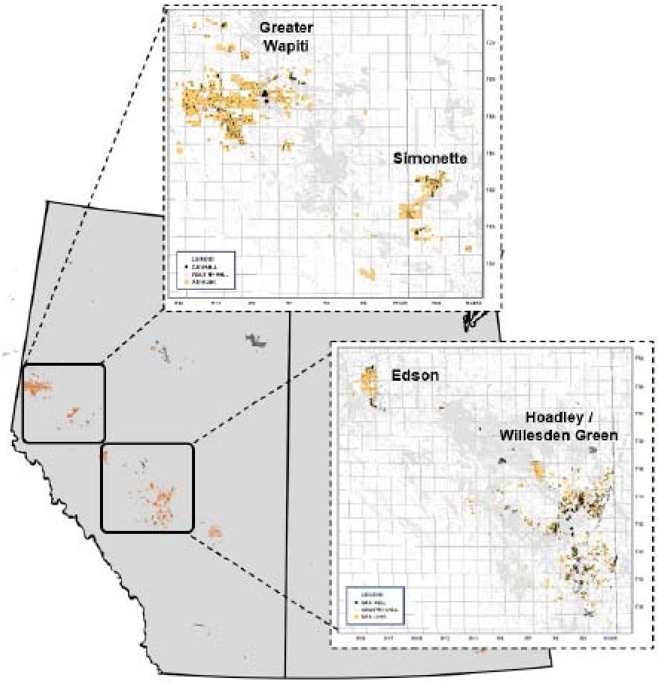
GAIN ASSETS

As of the start of 2020, the Gain portfolio included some 9,500 boepd of net production from over 1,250 wells (gross). Working interests vary on a well by well basis, with Gain having a high, 78% average working interest in its 242 operated wells, and a 14% stake in its c.1,050 non-operated wells. The Gain assets can be broadly split into two packages; the Northwest Package and the Central Package. Both packages are relatively low decline (average decline rates between c.10% and c.15%), which is largely a function of being typically mature conventional wells (>15 years old on average). The wells are predominantly vertical or deviated producers (>85%), with average legacy flow rates of c.30 boepd.

The Northwest Package produces c.4,300 boepd, predominantly from the Greater Wapiti and Simonette fields in western Alberta (see Figure 6, below), and includes ~475 (gross) production wells, with an average c.81% working interest in operated wells, and a 14% interest in non-operated wells. Liquids account for just under 50% of net production, although Proved Undeveloped (PUD) and 2P reserves are weighted slightly more favourably towards oil (accounting for 61% and 51%, respectively). 2P reserves are estimated at 25.8 mmboe (net), of which 8.7 mmboe are classified as PDP.

The Northwest package includes substantial operated infrastructure, particularly around the c.1,000 boepd (net) Simonette field. This infrastructure includes pipelines, storage facilities, compressor stations and water disposal facilities. These provide a small amount of 3rd party revenue (c.US$1m/annum), but also provide optionality when it comes to offtake, which can improve price realisations.

Figure 6: Gain Alberta assets (Northwest and Central packages)



Sources: i3 Energy

The vendors have identified some 365 development drilling locations in the Northwest package (c.160 net to working interest), including a 38 well plan on the North Simonette Montney field which would add some 9,500 boepd of net production. These undeveloped reserves are likely to become more significant once the oil price environment / M&A market conditions shift to a point at which greater returns can be made through organic development rather than acquisitive growth.

The Central package comprises c.5,200 boepd of net production, c.65% of which is dry gas. The assets are spread over a number of fields to the south and west of Edmonton, in south-central Alberta (see Figure 5, above). The Central package 2P reserve base stands at c.35.5 mmboe, of which 12.75 mmboe is classified as PDP. The package includes over 800 (gross) production wells, with i3 having a c.76% average working interest in its operated wells and a 14% interest in the non-operated wells.

Owned infrastructure in the Central package includes two gas plants and a compression station. These provide additional 3rd party processing revenue totalling over US$1m/annum, and have the additional benefit of reducing group operating costs by some US$0.7/boe (due to lower processing fees).

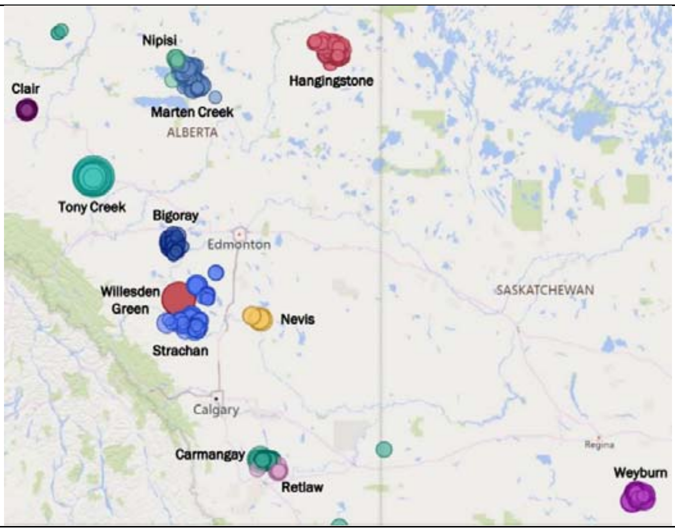
The Central package also includes an undrilled well inventory of 260 locations, with an average working interest of 41% (c.56 net locations).

TOSCANA ASSETS

The Toscana portfolio includes 255 wells, with an average working interest of 69% (175 net wells). The assets include interests in 13 conventional fields across Alberta and Saskatchewan, and include a significant degree of overlap with the Gain portfolio (see Figure 9, below).

The Toscana portfolio produces in the region of 1,000 boepd (net), including 55% light oil and condensate and 45% dry gas. Audited 2P reserves at the end of 2019 totalled 4.65 mmboe, of which 2.67 mmboe is classified as PDP.

Figure 9: Toscana portfolio



Sources: i3 Energy.

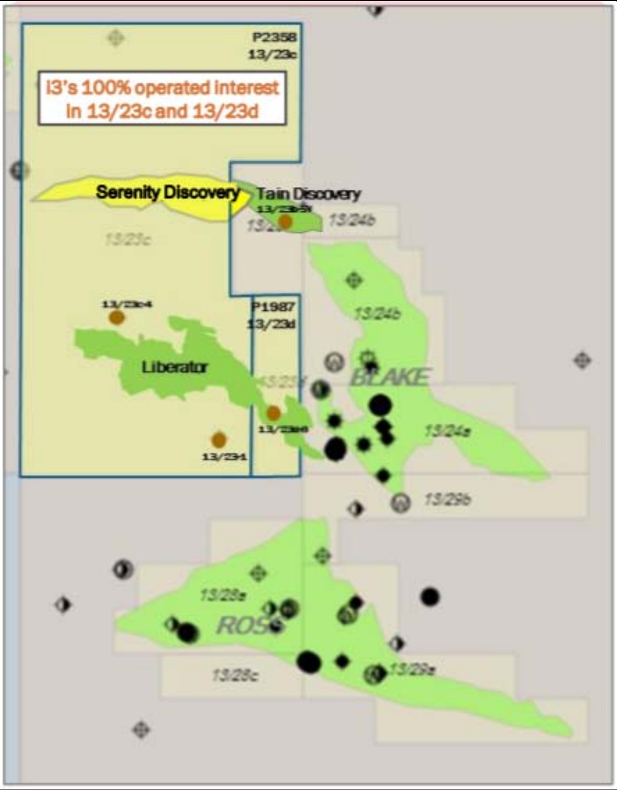
As with the Gain assets, the Toscana portfolio includes a number of opportunities to boost near term production with debottlenecking, infill drilling, and E&A drilling.

In addition to the upstream portfolio, i3 has inherited Toscana's operational team and office. This will serve as the platform on which to grow the Canadian side of the business. Furthermore, the Toscana deal provides a North American shareholder base for the secondary listing i3 is pursuing on the TSX exchange in Canada, and, includes some US$94m of accumulated tax losses which will serve to offset i3's Canadian tax liabilities for the foreseeable future.

ASSET OVERVIEW: UK CONTINENTAL SHELF

i3 Energy has a 100% stake in Blocks 13/23c and 13/23d, two licences situated in the Outer Moray Firth within the prolific South Halibut Basin. The blocks are situated close to some large producing oil fields, including Captain and Blake. The licences contain two undeveloped oil discoveries, Serenity and Liberator (see Figure 10, below).

Figure 10: Blocks 13/23c and 13/23d, Outer Moray Firth



Sources: i3 Energy

SERENITY

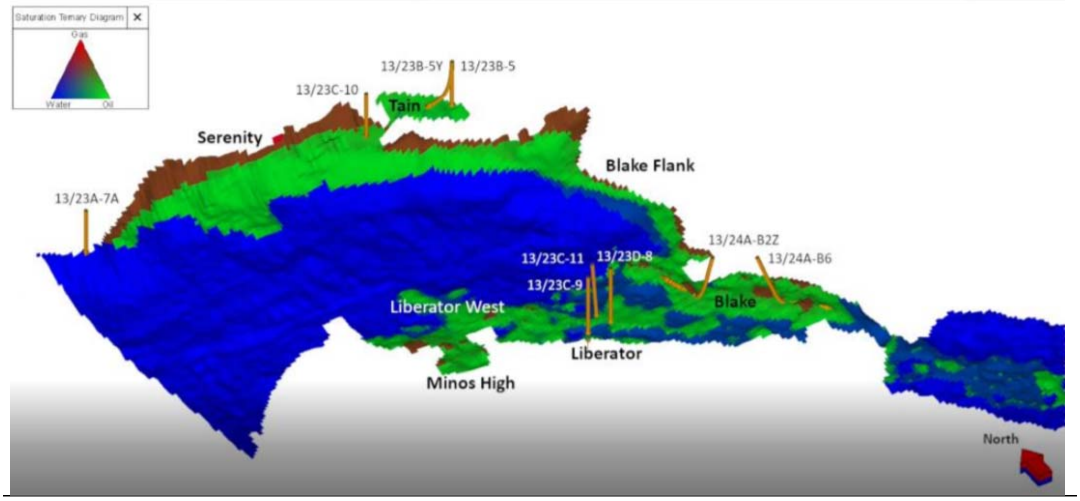
Serenity is situated at the northern edge of Block 13/23c. The discovery was made with i3's well 13/23c-10 in October 2019, with light oil encountered, as expected, within high quality Captain sandstones. A full suite of logs were taken, and i3 believes that pressure data suggests the structure is a westerly extension of Repsol Sinopec's Tain field (as in Figure 10, above). According to the subsurface model (see Figure 11, below), Tain forms an attic of Serenity, and is indeed further connected (or at least was once connected) to the large Blake field, to the south-east.

i3 estimates that there could be as much as 197 mmbbls STOIIP (note local recovery factors for the prolific Captain sands can ultimately exceed 50%), based on an assumed thickening of the sands to the west (as evidenced by a water-wet well drilled by Talisman in 2005). In order to delineate Serenity, therefore, additional appraisal drilling is required on the western flank of the structure.

Meanwhile Repsol has commenced a field development plan approval process for the neighbouring Tain discovery. The Tain partners, which also includes London-listed E&P RockRose (whose sale to Viaro is expected to complete in early September), have submitted the environmental statement for the project, which is designed to drain 10 mmbbls with a peak production rate of c.8,000 bopd. Under the current proposal, modifications to the Bleo Holm FPSO in order to handle Tain crude are due to be undertaken next year, with development drilling following in Q1 2022.

During the field development approval process for Tain, field boundaries will be determined, and if it is agreed that Tain and Serenity are connected then unitisation will naturally be considered. If satisfied that the two are interconnected, it may make sense to integrate Serenity and/or Liberator into the plans for Tain (note the FDP can be modified post submission, to factor in any subsequent appraisal drilling results). Alternatively a settlement could be made to account for the impact of a Tain development. We would caveat here, however, that we would be surprised to see a final investment decision made by Repsol on Tain, without stronger and more stable oil prices.

Figure 11: Block 13/23d subsurface model



Sources: i3 Energy.

LIBERATOR

Liberator is an elongated structure which covers a relatively large area. Due to the relatively small oil column (the fact that the top reservoir is close to the oil water contact) and the irregular (bumpy) top reservoir surface in the eastern portion of the field, the structure has a complex pattern, almost patchy in nature (see Figure 11).

Thanks to the wealth of well data in the area, the oil water contact and the reservoir presence is relatively well understood, however the key challenge, at least to the south of the licence around Liberator, is establishing the areas of reservoir lying above the contact level. This task is made more complicated by the fact that the thicknesses in question are frequently smaller than the resolution of 3D seismic – hence last year's mixed appraisal drilling results. With the standout exploration success at Serenity, and this complexity at Liberator considered, we expect i3's North Sea efforts to focus on Serenity, for now at least.

VALUATION & CASH FLOW FORECASTS

CASH FLOW FORECASTS

Our cash flow forecasts assume i3 completes the Toscana and Gain acquisitions at the end of Q3 2020, with the first full year of production in FY21. Our central case is based on the PDP reserve profile, augmented for a conservative amount of development activity to hold production flat over the forecast period (FY20-23). As the timing of any future inorganic growth is unclear we have excluded this source of potential growth in our numbers.

- Commodity price assumptions: Our revenue forecasts are based on Brent oil prices averaging US$40/bbl in 2020, rising in US$5/bbl increments to US$60/bbl by 2024 (from which point we have assumed US$60/bbl long term). Our local realised price assumes a US$6/bbl discount to Brent, which is broadly consistent with the Edmonton Light forward curve, less transportation costs. For gas, we have used the Henry Hub strip price of US$2.74/mcf in 2021, US$2.74/mcf in 2022 and US$2.55/mcf in 2022. We have assumed a local price differential of -US$0.5/mcf in 2021, rising to -US$0.75/mcf thereafter.

- Opex: Our financials assume a blended unit opex cost of c.US$11-12/boe including royalties. On top of this we have assumed an additional US$6.7m/annum of fixed G&A costs, equivalent to c.US$2/boe.

Figure 12: P&L summary

		2019	2020	2021	2022	2023
Net oil & gas	boepd	-	2,458	9,046	9,096	9,142
Average realised oil & gas price	US$/boe	-	17.0	21.4	21.5	24.7
Net gas volumes	mmscf/d	-	8.3	30.7	30.8	30.7
Realised gas price at sales point	US$/mcf	-	1.6	2.2	1.8	2.3
Net gas revenue	US$m	-	4.9	25.1	20.3	25.2
Net NGL & condensate volumes	boepd	-	632	1,918	1,945	2,055
Realised liquids price at sales point	US$/bbl	-	18.9	21.6	24.3	27.0
Net liquids revenue	US$m	-	4.4	15.1	17.3	20.3
Net oil volumes	boepd	-	450	2,014	2,014	1,973
Realised oil price at sales point	US$/bbl	-	34.0	39.0	44.0	49.0
Net oil revenue	US$m	-	5.6	28.7	32.3	35.3
Third party income	US$m	-	0.4	1.6	1.6	1.6
Revenue	US$m	-	15.2	70.5	71.5	82.4
Operating costs (including royalties)	US$m	-	(8.6)	(36.3)	(36.6)	(38.1)
Unit	*US$/bbl*	-	*(9.6)*	*(11.0)*	*(11.0)*	*(11.4)*
G&A (recurring)	US$m	(9.5)	(7.1)	(7.1)	(7.1)	(7.1)
Unit	*US$/bbl*	-	*(7.9)*	*(2.2)*	*(2.1)*	*(2.1)*
EBITDAX	US$m	(9.5)	(0.5)	27.1	27.8	37.2
EBITDAX margin	*%*	-	*(3.4%)*	*38.4%*	*38.8%*	*45.2%*
DD&A	US$m	-	(4.0)	(14.9)	(14.9)	(15.0)
Finance and other expenses	US$m	(4.7)	(4.3)	(5.4)	(5.4)	(3.9)
Pre-tax profits	US$m	(14.2)	(8.9)	6.8	7.5	18.3
Tax	US$m	-	-	-	-	-
Net income	US$m	(14.2)	(8.9)	6.8	7.5	18.3
Earnings per share (fd)	*c/shr*	-	*(1.1)*	*0.8*	*0.9*	*2.2*

Source: Mirabaud Securities

- EBITDAX: As illustrated in our P&L summary in Figure 12 (above), we forecast group EBITDAX of US$27m in FY21, rising to c.US$28m in 2022, and above US$37m in 2023. This is equivalent to healthy EBITDAX margins of c.35%-50%.

- Taxes & royalties: The Toscana transaction includes some US$94m of accumulated tax losses which shelters the enlarged portfolio over the coming few years. Additional capital allowances, including generous abandonment allowances, continue to offset tax over the long term.

Figure 13: Cash flow and balance sheet summary

	US$M	2019	2020	2021	2022	2023
Pre-tax profits		(14.2)	(8.9)	6.8	7.5	18.3
Cash flow reconciliation (non-cash + finance exp.)	US$m	7.2	8.4	20.2	20.3	18.9
Working capital movements	US$m	0.2	(21.5)	-	-	-
Interest	US$m	-	-	(2.9)	(2.9)	(1.4)
Tax paid	US$m	-	-	-	-	-
Net operating CF	US$m	(6.8)	(22.0)	24.2	24.9	35.8
Cash flow margin	*US$/bbl*	-	*(24.5)*	*7.3*	*7.5*	*10.7*
Capex (inc. abandonment)	US$m	(27.6)	(5.3)	(9.6)	(9.6)	(9.6)
Free cash flow	US$m	(34.3)	(27.3)	14.6	15.3	26.2
Dividend paid	US$m	-	-	(4.4)	(5.7)	(8.4)
Acquisitions/divestments	US$m	(0.6)	(25.0)	-	-	-
Movement in debt, other	US$m	28.8	-	-	-	(35.7)
Share issuance (net of costs)	US$m	30.6	36.1	-	-	-
Net increase (decrease) in cash	US$m	24.5	(16.2)	10.2	9.6	(17.9)
Cash (inc. restricted)	US$m	25.0	8.8	19.0	28.6	10.7
Other current assets	US$m	0.4	0.4	0.4	0.4	0.4
O&G assets	US$m	61.0	103.8	96.5	89.0	81.5
Total assets	US$m	86.3	113.0	115.9	118.1	92.6
Debt	US$m	17.1	32.0	32.0	32.0	-
Other liabilities (inc. abandonment)	US$m	27.8	27.3	27.7	28.1	28.6
Shareholder equity	US$m	41.5	68.7	71.1	72.8	64.1
Total equity & liabilities	US$m	86.3	127.9	130.8	133.0	92.6
Financial metrics		-				
P/E - adjusted, fd	*X*	-	-	*7.3x*	*6.7x*	*2.7x*
EV/EBITDAX	*X*	-	-	*2.7x*	*2.3x*	*1.4x*
Dividend yield	*%*	-	-	*8.9%*	*11.4%*	*16.9%*
Dividend cover	*x*	-	-	*3.3x*	*2.7x*	*3.1x*
FCF yield	*%*	-	-	*29.3%*	*30.7%*	*52.4%*
Net debt / EBITDA	*x*	-	-	*0.9x*	*0.5x*	*0.1x*

Source: Mirabaud Securities.

- Capex: Our capex assumptions include US$7.5m/annum of maintenance costs. This is based on a broad-brushed assumption that development wells, on average, cost around US$1.5m (tied-in), and IP rates are in the 200-300 boepd region. Four or five wells per year should be sufficient to offset natural decline, which at 13% would require around 1,300 bopd to be replaced. Note that i3 paid just US$2.8m for Toscana, which included in the region of 1,000 boepd. While there is this sort of value in the M&A market, in practise i3 is more likely to offset decline through inorganic acquisitions. Our annual capex budget also includes some US$2.1m/year of abandonment costs.

- Corporate matters: We estimate that, by year end, i3 will have a comfortable c.US$9m of cash on the balance sheet. Under the terms of its 2023 loan notes (see section below), we have i3 paying cash interest from 2021, at around US$3m/annum, before settling in cash at maturity. In terms of dividends, we have modelled the first payment in H1 next year, with US$4.4m returned to shareholders over the course of 2021. In subsequent years we have modelled 25% of free cash flow paid out. This provides a progressive dividend yield, rising from 8.9% in 2021 to 17% in 2023. Even with these relatively generous returns, our model shows cash building strongly on the balance sheet, rising to c.US$30m by the end of 2022.

DCF ANALYSIS

We have built two models for the Canadian Developed Producing and 2P cases, as well as a North Sea model for the development of Serenity. We calculate a Core NAV of US$56m (5.1p/shr), with a further US$108m (9.8p/shr) of risked NAV associated with the Canadian 2P reserve base, taking 2P NAV to US$164m (14.9p/shr). Our US$218m (19.8p/shr) Total NAV also includes US$54m (4.9p/shr) of risked value attributable to Serenity. This analysis is based a 10% discount rate (start date of 1 Jan 2021), and long term (from 2023 onwards) oil and gas prices of US$60/bbl (Brent) and US$3/mcf (Henry Hub), respectively. A summary of our NAV and the key assumptions is shown in the table below.

Figure 14: Valuation summary table

NET ASSET VALUE

Asset	Gross mmboe	Interest	Net mmboe	US$/boe	Unrisked US$m	Unrisked p/shr	CoS	Risked US$m	Risked p/shr
Canada DP reserves	n/a	n/a	26.0	2.9	76	6.9	100%	76	6.9
Deduct: net debt*					(23)	(2.1)		(23)	(2.1)
Add: corporate items					3	0.3		3	0.3
Core NAV			26.0		56	5.1		56	5.1
Canada 2P reserves	n/a	n/a	32.5	4.4	144	13.1	75%	108	9.8
2P NAV			58.5		200	18.2		164	14.9
Serenity	17.5	100%	17.5	10.34	181	16.4	30%	54	4.9
Total NAV			76.0		381	34.6		218	19.8

Valuation assumptions:

Brent price: US$45/bbl 2021, US$50/bbl 2022, US$55/bbl 2023 & US$60/bbl flat thereafter.

NGL price (at local sales point): 45% of Brent long term.

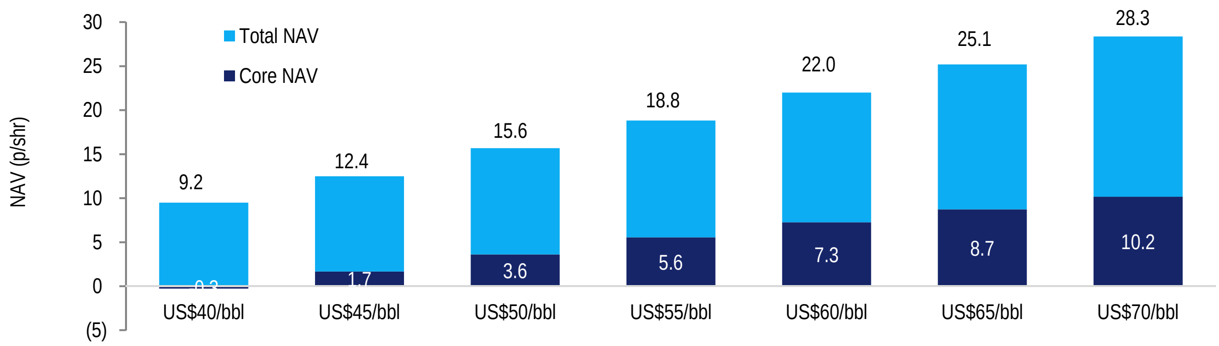
Henry Hub gas price: US$2.74/mcf 2021, US$2.55/mcf 2022, US$3.0/mcf 2023 flat thereafter.

Discount rate 10%.

1.31 US dollar / sterling.

693.3m ordinary shares outstanding post Toscana acquisition. 147.82m options and warrants outstanding with exercise prices 0.01p-11p/shr.

Oil price sensitivity – NAV at various flat Brent prices (2021 onwards):



Source: Mirabaud Securities. *Forecast net debt at YE20.

- Core NAV: Our Developed Producing NAV can be considered the 'base case'. This model assumes that virtually no discretionary capex is spent, meaning that production declines naturally from day one. Overall, we value DP reserves at around US$2.9/bbl, implying an NPV10 of US$76m (6.9p/shr). Our Core NAV includes our forecasted net debt at year ending 2020 (totalling US$23m, or 2.1p/shr), as well as US$3m (0.3p/shr) of proceeds from the exercising of options and warrants (in-the-money, or near-in-the-money only). The result is a Core NAV of US$56m (5.1p/shr).

- 2P NAV: Our 2P NAV is based on a model of the Canadian 2P reserve base (58.5 mmboe). In this scenario we have assumed that i3 invests in its portfolio to grow production organically. Accordingly our model has net production growing to a peak of almost 14,000 boepd in 2023. We have assumed a total capex spend of c.US$165m, phased over the next five or six years. We have risked the 2P NAV at 75%, to reflect the timing and operational risk associated with the development of new reserves. As such we attribute an incremental US$108m (9.8p/shr) of value to the 2P reserve base, resulting in a risked 2P NAV of US$164m (14.9p/shr).

- Total NAV: Our Total NAV includes the Serenity discovery in the North Sea. With only one well in the structure to date, we have assumed a conservative 50 mmbbls STOIIP development, and applying a 35% recovery factor results in some 17.5 mmbbls gross, recoverable. Using our DCF-derived NPV10 of US$10.34/bbl, we estimate unrisked NAV at US$181m. Applying a cautious 30% chance of success (predominantly commercial risks as opposed to geological), we calculate a risked, North Sea NAV of US$54m (4.9p/shr).

2023 LOAN NOTES

i3 has £24.5m of outstanding secured loan notes. The notes are held by just four holders (including Bybrook Capital, BP Oil International, James Caird Asset Management and Lombard Odier), which also hold a material position in i3 equity, with a combined 39% stake in the company (fully diluted), prior to the latest fund raising. The notes mature in May 2023, and pay a coupon of either 8% cash, or 11% payment-in-kind, at the election of i3.

Reflecting the fact that the noteholders are closely aligned with equity holders, the conditions of the paper are relatively amiable. i3 is required to either execute an agreement for at least 2,500 boepd of net production, raise a minimum of £15m of new financing or farm-out Serenity, by the end of September – two of which would be satisfied on completion of the Gain transaction. In addition, i3 is required to achieve net production of above 5,000 boepd by the end of April next year – again this condition will be satisfied by completion of the Gain deal. Otherwise there are no maintenance covenants on the facility.

PEER ANALYSIS

While i3 will become the only AIM listed E&P of size with operations in Canada, we have compiled a table comparing the London listed producers (10 kboepd+) which we consider most relevant as market comps. As the table shows, i3 will be highly competitive on all metrics. It will be one of only a small number of well-covered dividend payers, and looks attractive on free cash flow yields, EV/flowing barrel and EV/2P reserve metrics.

Figure 15: Peer analysis

	MKT CAP US$M	NET DEBT US$M	EV US$M	2P MMBOE	PRODUCTION BOEPD	EV/2P US$/BOE	EV/FLOWING BBL US$/BOEPD	2021 FCF US$M	FCF YIELD %	DIVIDEND YIELD %
i3E pro forma	49.9	(23)	73.1	58.5	10,574*	1.25	6,913	14.6	29%	8.9%
Gulf Keystone	274.1	(86)	188	462.4	26,306	0.41	7,135	42.8	16%	-
Genel Energy	483.3	(93)	390	124.0	34,170	3.15	11,423	19.9	4%	-
Serica Energy	407.8	(133)	274	62.3	30,000	4.41	9,148	24.2	6%	2.5%
Pharos Energy	81.2	42	123	49.9	11,589	2.46	10,608	3.9	5%	-
Cairn Energy	1053.4	136	1190	142.0	23,000	8.38	51,732	(287.9)	-27%	-
Seplat	393.1	458	851	509.0	48,491	1.67	17,552	174.5	44%	15.6%
Savannah Ener.	107.7	345	453	71.0	15,680	6.38	28,870	10.7	10%	-
Diversified G&O	1013.4	678	1691	685.0	101,800	2.47	16,615	226.3	22%	10.1%
EnQuest	287.3	1,413	1700	213.0	60,000	7.98	28,338	221.0	77%	-
Premier Oil	254.5	1,990	2244	175.0	78,400	12.83	28,629	224.8	88%	-
Tullow Oil	426.7	2,806	3233	243.0	75,000	13.30	43,102	33.2	8%	-
					AVERAGE**	5.77	23,014		23%	

Source: Mirabaud Securities, prices as of 25/8/2020. *Based on Q4 2019 production. **Average ex. i3

BOARD & MANAGEMENT

I3 Energy started out life as a North Sea pure play, before diversifying into Canadian production. The company is spearheaded by Majid Shafiq (CEO) and Graham Heath (CFO), a co-founded of the company, and boasts an experienced Board & management with a variety of backgrounds.

BOARD OF DIRECTORS

Majid Shafiq, Chief Executive Officer

Majid Shafiq has over 30 years of technical and investment banking experience focused on the global E&P sector. Prior to becoming CEO of i3 in 2018, Majid spent 16 years in energy investment banking advising on asset level acquisitions and divestments, corporate M&A and equity financing for the private and public, small to mid-cap oil and gas sector. During that time he worked for Waterous and Co, Tristone Capital Ltd, FirstEnergy Capital LLP and Argentil Capital Partners. Prior to his investment banking career, he worked for Mobil Oil Corporation for 13 years in various petroleum engineering and commercial roles. Majid holds a Bachelor's degree in Nuclear Engineering from Manchester University, a Master's degree in Petroleum Engineering from Heriot-Watt and an MBA from London Business School.

Graham Heath, Chief Financial Officer and Co-founder

Prior to co-founding i3, Graham served as VP Corporate Development and later as Interim CFO at Iona Energy. During his time at Iona, Graham worked with the senior management team to build the company from infancy to 40MMboe of 2P reserves and production above 6,000 boe/day, listing the company on the Toronto Venture Exchange, and structuring equity, debt, and derivative financings in excess of US$670million. Prior to joining Iona, Graham Heath's 15 year career focused on energy-related tech startups and consulting within Alberta's Oil and Gas Industry, working with the likes of Colt Engineering, PanCanadian Petroleum, EnCana Corporation and Cenovus Energy. Graham Heath holds a Bachelor of Commerce from the University of Calgary.

Linda Beal, Non-Executive Chairperson

Linda has over 30 years' experience advising international E&P clients and since 2016 has been a board member of numerous companies. As a director of other small cap natural resources businesses, she brings corporate governance and financial expertise and experience as Audit Committee Chair. Linda joined Grant Thornton in 2013 as a Tax Partner and was Global Leader for Energy and Natural Resources, mandated to build its global energy and natural resources capability. Previously, Linda spent 30 years at PwC and its legacy firm Price Waterhouse in Audit and Tax, 16 of them as a Partner. Launching PwC's Natural Resources Independents business in the mid-2000s, she focused on advising international E&P clients across the AIM, FTSE350, overseas listed and private sectors.

Neill Carson, Non-Executive Director and i3 Co-founder

Neill has over 32 years of management and international project experience in the oil & gas industry. In early 2004, Mr. Carson co-founded Ithaca Energy Inc. where he served as its President and a Director from April 2004 and acted as Chief Operating Officer until late 2007. While at Ithaca, Neill was responsible for asset acquisitions, all aspects of operations and safety, general corporate strategy, and the drilling of four successful oil wells. Neill founded Iona Energy in late 2007 where he served as CEO until his departure in mid-2014 to form i3. Responsible for all aspects of corporate strategy and portfolio development, he grew Iona to 40 MMboe of 2P reserves and saw peak production of 6,700 boe/day. Prior to Ithaca Energy, Neill spent 23 years at BP Amoco.

Richard Ames, Non-Executive Director

Richard brings to the i3 board 35 years of broad range experience in the oil and gas industry with senior executive roles in full-cycle oil and gas exploration and production, information technology and oil and gas services. He has held several Vice President positions in TNK-BP, Sidanco, and Amoco, where he was responsible for government liaison, the implementation of business strategies and the management of exploration and new venture projects. He has recently held Board and Advisory Board of Director positions in Iona Energy, Accenture

Russia, the Kiawah Conservancy, and DataSpace. Richard graduated from Duke University with a Bachelor of Science degree in Geology, and from the University of Georgia with a Master of Science in Geology.

John Festival, Non-Executive Director (to join on completion of the Toscana transaction)

On completion of the plan of arrangement between i3 and Toscana and subject to regulatory due diligence, John Festival, will join the board of i3 as a non-executive director. John, a current member of the Toscana board, is a chemical engineer with over 35 years of experience in the WCSB's oil and gas sector and has an excellent track record of founding, growing and monetising oil and gas ventures in Canada. He is currently the CEO of Broadview Energy and was the President and CEO of Black Pearl Resources Inc. prior to its acquisition by International Petroleum in December 2018 in a stock and debt transaction valued at circa C$715 million. He was previously the founder and President of BlackRock Ventures Inc. which was established in 2001 and sold to Shell Canada for C$2.4 billion in 2006.

I3 CANADA SENIOR MANAGEMENT

Ryan Heath, President, Toscana (to become i3 Canada)

Prior to joining Toscana in August of 2019, Ryan has enjoyed a successful 20-year career building junior oil and gas companies in the WCSB. Most recently, he was VP Land & Negotiations at Paredes Energy Corporation. Mr Heath has been instrumental in the growth and development of a number of junior E&P companies including Striker Exploration Corp., Hyperion Exploration Corp. and Severo Energy Corp. Throughout his earlier career, Mr Heath held roles of increasing Land Management and Business Development responsibility with Paramount Energy Trust and NCE Petrofund Corp. Mr Heath holds a Bachelor of Commerce in Petroleum Land Management from the University of Calgary's Haskayne School of Business and is an active member of the CAPL.

Mark Hadley, VP Exploration, Toscana (to become i3 Canada)

Mr Hadley has 32 years of diverse and successful experience as an oil and gas exploration geologist. Prior to Toscana, he most recently was a founder and VP Exploration at Paredes Energy. He was the VP Exploration of Kicking Horse Energy from 2014 through to its acquisition in December 2015 by ORLEN Upstream Canada. Mr Hadley was VP Exploration of Contact Exploration from 2011 to 2014 and Manager of Geology at Fairborne Energy from 2002 to 2011. Previous to that he has had roles at Range Petroleum, Suncor Energy, PanCanadian Petroleum Ltd. and Husky Energy. Mr Hadley holds an M.Sc in Geology from the University of Alberta, and an H.BSc in Geology, from the University of Western Ontario. He is an active member of APEGA.

Ian Schafer, VP Business Development, Toscana (to become i3 Canada)

Mr Schafer has over 18 years of diverse oil and gas engineering and operational experience. Prior to joining Toscana alongside Ryan Heath and Mark Hadley in August of 2019, he was a founder and the Vice President of Engineering at Paredes Energy Corporation and prior to that, Mapan Energy Ltd., a publicly traded natural gas company acquired by Tourmaline Oil Corp. in August 2015. Throughout his career, he has held roles of increased responsibility with various-sized public and private growth companies. Mr Schafer holds a B.Sc. in Chemical Engineering with a minor in Petroleum, and an M.Eng. in Petroleum Engineering with a specialization in Reservoir Characterization. He is an active member of APEGA and SPE.

Anand Ramnath, CFO, Toscana (to become i3 Canada)

Mr Ramnath has over 20 years of diverse and successful experience as a finance professional. Prior to joining Toscana in 2012, Mr Ramnath ran a consulting practice and served clients in the energy sector. From 1996 to 2006, Anand worked with PricewaterhouseCoopers within their assurance and advisory divisions. Anand is member of the Chartered Professional Accountants of Alberta and holds a Bachelor of Commerce degree from Bangalore University.

DISCLAIMER

RECOMMENDATIONS HISTORY

Market index : FTSE AIM O&G

Date	Market Index level	Share Price (p)	Target Price (p)	Opinion
i3 Energy	FTSE AIM O&G			
1 Sep 2020	1,065.38	5.5	10.0	BUY

RATINGS, CERTIFICATION AND DISCLOSURE

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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.

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

RISK QUALIFIER: Speculative: The stock bears significantly higher risk that typically cannot be valued by normal fundamental criteria and investment in the stock may result in material loss.

The ratings are applicable to all research produced after 1st January 2016

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