

i3 Energy (I3E LN)

MARKET DATA

Bloomberg	ticker	I3E LN
Share price	p/shr	12.88
Target	p/shr	28.5
TP upside	%	121%
Shares out	Million	1,125.0
Fd shares	Million	1,287.4
Mkt cap	US\$m	201.3
EV	US\$m	194.4

SITTING PRETTY

Through a series of timely acquisitions since mid-2020, i3 Energy has established itself as a material, low risk producer in Canada, with a strategy designed to generate capital growth and income. The company currently produces c.18,750 boepd (liquids:gas split c.48:52) in the West Canadian Sedimentary Basin (WCSB), with c.25% of near term production hedged to protect the dividend and the balance exposed to rising commodity prices. With local gas prices up c.40% and oil prices up c.15% since mid-year alone, i3 is set for a profitable H2, following on from the recently published, solid set of H1 financials. Having re-run our numbers, the key change being near term commodity price assumptions brought in line with the forward strip, we calculate a risked Total NAV of 28.5p/shr at which we base our Target Price. At the current share price of 12.88p/shr, this offers over 100% upside, on top of a healthy running dividend yield of 6.7%. Accordingly, we reiterate our BUY recommendation.

Figure 1: Summary financial forecasts

		2021	2022	2023
Production, net	kboepd	12,546	17,875	16,687
Av. price*	US\$/boe	29.5	30.3	28.1
Revenue	US\$m	128.3	197.4	171.4
EBITDA	US\$m	54.1	96.2	76.3
Margin	%	42%	49%	45%
FCF[‡]	US\$m	35.5	81.9	54.3
FCF yield	%	17.6%	40.7%	27.0%
Dividend yield [†]	%	2.3% [†]	6.7% [†]	6.7% [†]
FCF / dividend (cover)	x	7.5x	6.1x	4.0x
Net debt / EBITDA	x	0.5x	-	-

Source: Tennyson Securities. *Blended average. [‡]Net cash flow, post capex, pre dividend. [†]Paid yield.

Higher realised pricing drives revenue upgrades

Global energy prices have enjoyed a strong year, with demand levels rebounding strongly as the world gradually recovers from covid. This, in conjunction with limited new supply coming onstream, has resulted in a squeeze on oil, and to an even greater extent, gas prices. i3's benchmark gas price is the Alberta trading price, AECO, which, as illustrated in Figure 2, below, has been climbing steadily since the start of Q2 this year. Since the start of April the winter strip price has almost doubled, now trading at US\$4.2/mcf (for context our previous financial forecasts assumed an average realized gas price of US\$2.88/mcf for FY21 and US\$3/mcf for FY22). Meanwhile, the global Brent oil benchmark has risen by >30% over the same period, currently trading at US\$84.7/bbl. This recent strength is also reflected in the forward strip prices, with the 2022 AECO strip indicating average prices of US\$3.5/mcf and the Brent forward strip US\$79/bbl.

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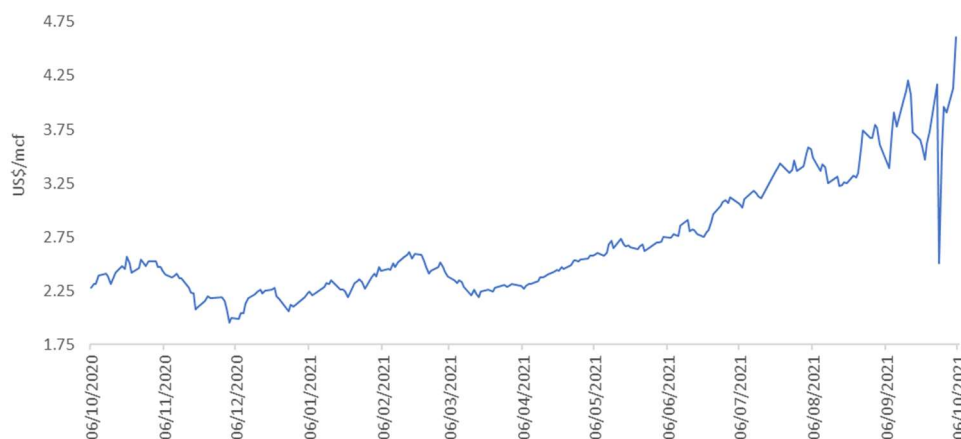
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Figure 2: AECO winter strip Natgas

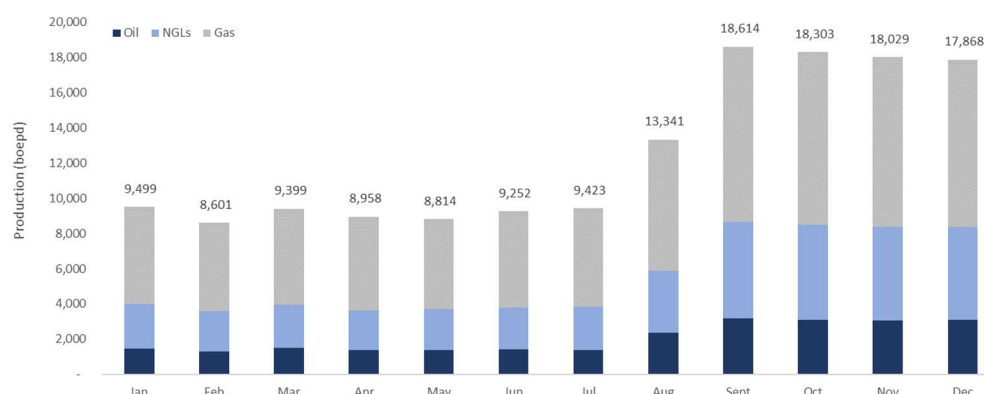


Source: Bloomberg

Solid operational performance

The rally in commodity prices have coincided with solid operational performance. Production over the course of 2021 has been stable, with modest levels of decline mitigated against through workovers, development well drilling and small-scale M&A. These activities kept production range bound over the course of 2021, at rates of between 8,500 and 9,500 boepd. As Figure 3 illustrates, the step change occurred in August through the acquisition of a suite of assets from Cenovus Energy. This roughly doubled production to c.18,600 boepd. The chart in Figure 3 shows a production forecast for the remainder of the year declining under a ‘blow-down’ scenario. This illustrates the expected production decline on the basis of no further investment in the asset. In practice however, we expect i3 to continue to invest in the types of activities which kept production stable during the first half of the year.

Figure 3: 2021 monthly production and Q4 forecast (blow down scenario)



Source: i3 Energy

Closing in on Serenity farm out

i3 has announced that it has agreed indicative farm out terms in principle with prospective partners at Serenity. i3 is awaiting funding commitments from the counterparties before finalizing the deal, at which point the terms of the agreement can be announced. Should a deal be secured, we would expect i3 to be carried through the bulk of the costs of a 2022 drilling campaign, while maintaining a material interest in the asset.

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Financial forecasts and valuation

On the back of the recently published interim results, we have updated our numbers, including upping our near-term commodity price forecasts in line with the forward strip (our long-term assumptions effectively remain unchanged at US\$60/bbl oil and US\$2.5/mcf gas). Next year we estimate average production of just under 18,000 boepd, leading to gross revenues just shy of c.US\$200m. This flows through on margins of 49% to EBITDAX of US\$96m – placing the company on an FY22 EV/EBITDA multiple of just 2.0x.

After accounting for around US\$14m of FY22 capex spend (including new wells and asset retirement obligation), we estimate a FY22 cash dividend payout of US\$13.5m – equivalent to 1.2c/shr and a running dividend yield of 6.7% at today's prices. This still leaves almost US\$70m of cash building on the balance sheet, which can be used for either organic or inorganic growth. Our full financial forecasts are shown on page 4.

In terms of our DCF valuation, the tweaks to our model inputs have increased Core NAV by 7.5% to 22.7p/shr. Our risked Total NAV has increased by a similar amount to 28.5p/shr, where, incidentally, we set our Target Price.

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Figure 4: Valuation summary table

NET ASSET VALUE										
Asset	Gross		Net		Unrisked		Risked			
	mboe	Interest	mboe	US\$/boe	US\$m	p/shr	CoS	US\$m	p/shr	
Canada PDP reserves	n/a	n/a	50.4	3.8	190	10.6	100%	190	10.6	
Canada 2P reserves	n/a	n/a	82.2	3.3	270	15.1	75%	203	11.3	
Deduct: net cash*					7	0.4		7	0.4	
Add: corporate items					8	0.4		8	0.4	
Core NAV			132.6		475	26.5		407	22.7	
Serenity	69.0	100%	69.0	11.89	820	45.8	13%	102	5.7	
Total NAV			201.6		1,295	72.3		510	28.5	

Valuation assumptions:

Brent price: US\$73.0/bbl 2021, US\$76.9/bbl 2022, US\$70.9/bbl 2023, US\$66.6 2024, US\$60/bbl flat thereafter.

NGL price (at local sales point): 35% of Edmonton Light long term.

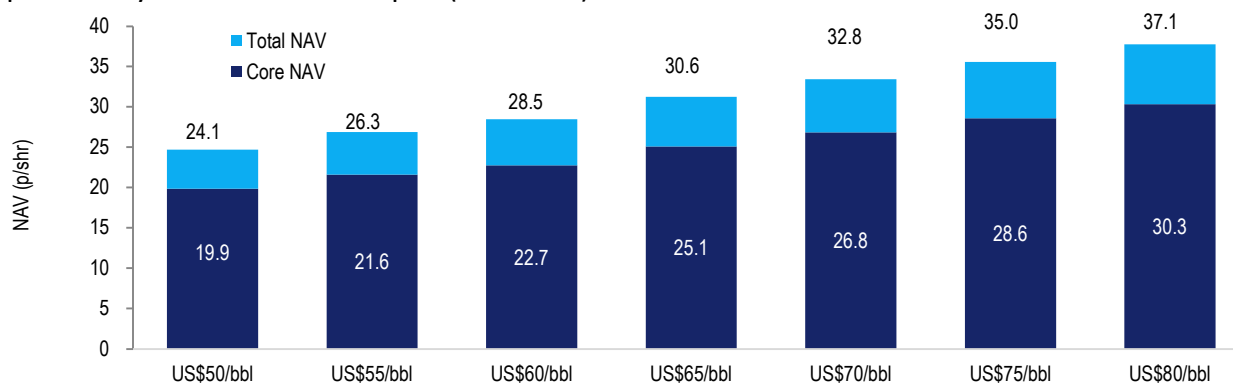
AECO gas price: US\$2.9/mcf 2021, US\$3.3/mcf 2022, US\$2.7/mcf 2023, US\$2.5/mcf flat thereafter.

Discount rate 10%.

1.39 US dollar / sterling.

1,125m ordinary shares outstanding. 162.4m options and warrants outstanding with exercise prices 0.01p-11p/shr.

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



Source: Tennyson Securities. *Forecast net debt at YE21.

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Figure 5: Financial summary – P&L, cash flow and balance sheet

FYE 31ST DEC		2020	2021E	2022E	2023E	2024E
Net oil & gas production	boepd	2,998	12,546	17,875	16,687	15,619
Average realised price	US\$/boe	19.0	30.6	30.3	28.1	27.5
Net gas volumes	mmscf/d	9.8	41.9	56.8	51.2	46.0
Gas revenue	US\$m	8.6	46.7	68.9	51.2	42.5
Net NGL volumes	bpd	843	3,477	5,300	4,770	4,293
NGL revenue	US\$m	4.8	33.8	46.6	38.3	32.1
Net oil volumes	bopd	517	2,082	3,100	3,390	3,651
Oil revenue	US\$m	7.1	55.4	77.9	77.9	78.1
Revenue	US\$m	20.8	128.3	197.4	171.4	156.7
Operating costs (inc. royalties)	US\$m	(12.1)	(60.2)	(87.2)	(81.1)	(75.5)
<i>Unit</i>	<i>US\$/boe</i>	<i>(11.1)</i>	<i>(13.1)</i>	<i>(13.4)</i>	<i>(13.3)</i>	<i>(13.3)</i>
G&A costs	US\$m	(7.8)	(14.0)	(14.0)	(14.0)	(14.0)
<i>Unit</i>	<i>US\$/boe</i>	<i>(7.2)</i>	<i>(3.1)</i>	<i>(2.1)</i>	<i>(2.3)</i>	<i>(2.5)</i>
EBITDA	US\$m	0.8	54.1	96.2	76.3	67.2
<i>EBITDA margin</i>	<i>US\$/boe</i>	<i>4.0%</i>	<i>42.2%</i>	<i>48.7%</i>	<i>44.5%</i>	<i>42.9%</i>
DD&A	US\$m	(6.6)	(27.7)	(39.4)	(36.8)	(34.5)
Finance and other expenses	US\$m	24.3	(9.4)	(8.1)	(9.1)	(9.7)
Profit before tax	US\$m	18.5	17.0	48.6	30.4	23.1
Income tax	US\$m	1.5	-	-	(7.7)	(7.8)
Net income	US\$m	20.0	17.0	48.6	22.7	15.3
Adjusted EPS (fully diluted)	c/shr	1.6	1.3	3.8	1.8	1.2
Profit before tax	US\$m	18.5	17.0	48.6	30.4	23.1
Cash flow reconciliation	US\$m	17.2	36.9	47.5	45.9	44.1
Working capital movements	US\$m	(3)	-	-	-	-
Interest paid, net	US\$m	(0.2)	-	-	-	-
Tax paid	US\$m	0.5	-	-	(7.7)	(7.8)
Net operating cash flow	US\$m	(1.2)	53.8	96.2	68.6	59.4
<i>Cash flow margin</i>	<i>US\$/boe</i>	<i>(1.1)</i>	<i>11.8</i>	<i>14.7</i>	<i>11.3</i>	<i>10.4</i>
Capex (including A&D)	US\$m	(24.2)	(18.3)	(14.3)	(14.3)	(14.3)
Free cash flow	US\$m	(25.4)	35.5	81.9	54.3	45.1
Dividend pay-out	US\$m	-	(4.7)	(13.5)	(13.5)	(13.5)
Acquisitions/divestments	US\$m	(24.8)	(43.4)	-	-	-
Debt movement, other	US\$m	-	-	-	-	-
Share issuance	US\$m	37.1	53.0	-	-	-
Net increase (decrease) in cash	US\$m	(13.1)	40.4	68.5	40.9	31.7
Cash	US\$m	8.4	48.8	117.3	158.2	189.8
Other current assets	US\$m	11.9	11.9	11.9	11.9	11.9
O&G assets	US\$m	214.4	246.5	218.8	193.7	171.0
Total assets	US\$m	234.7	307.2	348.0	363.8	372.8
Debt	US\$m	37.7	41.9	46.5	51.6	57.3
Other liabilities & decommissioning	US\$m	111.4	112.6	113.6	115.1	116.6
Shareholder equity	US\$m	99.8	166.8	202.0	211.3	213.1
Total equity & liabilities	US\$m	248.8	321.3	362.1	377.9	386.9
<i>P/E - adjusted, fd</i>	<i>x</i>	<i>-</i>	<i>11.9x</i>	<i>4.1x</i>	<i>8.9x</i>	<i>13.2x</i>
<i>EV/EBITDAX</i>	<i>x</i>	<i>-</i>	<i>4.3x</i>	<i>2.0x</i>	<i>1.7x</i>	<i>1.4x</i>
<i>Dividend paid</i>	<i>c/shr</i>	<i>-</i>	<i>0.42</i>	<i>1.20</i>	<i>1.20</i>	<i>1.20</i>
<i>Dividend yield</i>	<i>%</i>	<i>-</i>	<i>2.3%</i>	<i>6.7%</i>	<i>6.7%</i>	<i>6.7%</i>
<i>Dividend cover</i>	<i>x</i>	<i>-</i>	<i>7.5x</i>	<i>6.1x</i>	<i>4.0x</i>	<i>3.4x</i>
<i>FCF yield</i>	<i>%</i>	<i>-</i>	<i>17.6%</i>	<i>40.7%</i>	<i>27.0%</i>	<i>22.4%</i>
<i>Net debt /EBITDA</i>	<i>x</i>	<i>-</i>	<i>0.5x</i>	<i>-</i>	<i>-</i>	<i>-</i>

Source: Tennyson Securities. *Net of assumed US\$10.6m purchase price adjustment

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Market index: AIM ALL SHARE ENERGY

Date	Market Index level	Share Price (p)	Target Price (p)	Opinion
13 May 2021	1359.6	8.3	16.0	BUY
17 August 2021	1469.4	11.0	25.0	BUY
19 October 2021	1676.9	12.875	28.5	BUY

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