i3 Energy (I3E LN)

MARKET DATA

Bloomberg	ticker	I3E LN
Share price	p/shr	18.65
Target	p/shr	30.5
TP upside	%	63%
Shares out	Million	1,126.4
Fd shares	Million	1,288.8
Mkt cap	US$m	285.7
EV	US$m	303.0

FROM STRENGTH TO STRENGTH

Canadian oil and gas producer i3 Energy has had a stellar start to life since rebranding. The Cenovus acquisition, which roughly doubled the size of the business, completed in early Q3 shortly before the considerable strengthening of commodity prices. On the ground, operations continue to go well, with decline rates beating expectations and new wells being brought onstream more than offsetting natural declines. The company is sufficiently confident to move to a monthly dividend payout structure, providing investors with rapid returns and promoting the opportunity for shareholders to compound their stakes. In a sector which is offering considerable value across the board, we consider i3 to have an outstanding balance of low operational risk, substantial growth potential, and high shareholder returns. Having refreshed our numbers we calculate a Core NAV of 30.5p/shr, at which we set our target price, offering 63% upside from current levels, backed by a healthy running dividend yield of c.6.2%. Accordingly, we maintain our BUY recommendation.

Figure 1: Summary financial forecasts

		2021	2022	2023
Production, net	**kboepd**	**12,912**	**20,174**	**20,450**
Av. price*	US$/boe	31.4	35.6	31.9
Revenue	US$m	141.2	261.8	238.4
EBITDA	**US$m**	**40.5**	**138.7**	**117.3**
Margin	%	29%	53%	49%
FCF ᶲ	**US$m**	**21.9**	**88.2**	**79.4**
FCF yield	%	7.7%	30.9%	27.8%
Dividend yield⁺	%	1.6%⁺	6.2%⁺	6.2%⁺
FCF / dividend (cover)	x	4.6x	5.0x	4.5x
Net debt / EBITDA	x	0.72x	0.1x	-

Source: Tennyson Securities. *Blended average. ᶲNet cash flow, post capex, pre dividend. ⁺Paid yield.

Realised price rise continues

i3 continues to benefit from the strong and still rising commodity prices (see Figure 2). Following a correction during Q4 last year (sparked by the arrival of the Omicron variant) the benchmark Alberta gas price has recovered sharply, with the winter 2022/23 contract now trading in the region of US$3.5-4/mcf – comfortably above our long-term forecast of US$2.65/mcf. Similarly, after the Omicron blip, oil prices have bounced back even stronger, with Brent trading above US$90/bbl. i3's hedging policy protects the dividend and near-term capital commitments, but hedged volumes still only account for c.35% of near term production, leaving i3 strongly exposed to rising prices.

As before, our forecasts use forward strip pricing for the first three years, reverting to a flat long-term assumption from 2025. The sharp rise in the forward curves have lifted our average realized prices by 17% in 2022, 14% in 2023 and 8% in 2024. We have also taken the opportunity to increase our long-term Brent forecast from US$60/bbl to US$65/bbl (+8%), leaving our long term AECO gas price assumption unchanged for now at US$2.55/mcf.

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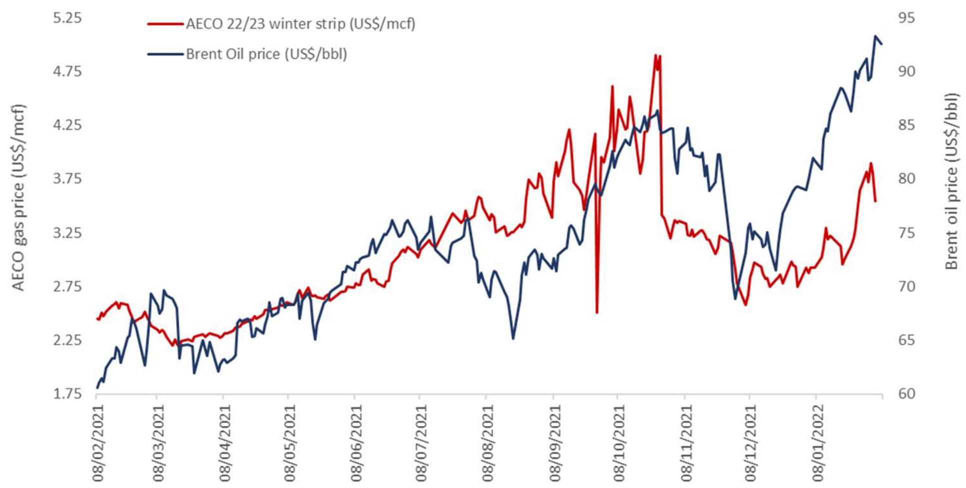
Figure 2: Commodity prices (AECO winter strip and Brent front month)



Source: Bloomberg

2022 work programme

Since rebranding as a Canadian production focused company, i3 has delivered on its remit. It envisaged expansion via M&A while commodity prices and asset valuations remained low, however prepared for organic growth as and when the cycle presented more cost-effective opportunities. While there are still targets in the M&A market – Canadian equity markets are yet to catch up with commodity prices, making rescue equity raises for i3 targets still challenging – levels of distress across the sector are starting to fall, and accordingly i3's attention will likely focus more on organic opportunities within its portfolio.

With this in mind, i3 recently outlined its minimum 2022 Canadian work programme, including a budget of US$47m to deliver some 17 new wells, and add some 5,250 boepd of incremental production. The drilling programme predominantly comprises low risk development wells, along with a smaller budget for appraisal drilling in growth areas such as the company's Clearwater acreage. There is also provision for maintenance, recompletions, and well reactivations.

The work programme is expected to boost 2022 exit rates by 26% versus a blow down scenario (zero investment), with full year average production forecast over 20,000 boepd, and peaks in excess of 21,000 boepd. It is worth noting that the blow down scenario assumes a pessimistic average decline rate of some 14% across the portfolio, which we would hope to be bettered, aided by the ongoing maintenance capital programme. Accordingly, we see the published production targets as being eminently achievable. i3 expects this capital programme to add some US$50m of net operating income to the end of 2023 versus the blow down scenario (based on strip pricing as of late December 2021). This implies that the company is paying comfortably under 2x cash flow (note the spend is spread over 2022, weighted slightly in favour of H2), and illustrates the efficacy of the model in both low and high commodity (and asset) price environments.

At last count, i3 had some 143 identified well targets and 80 net reactivations. With just 17 of these well targets to be drilled this year, and new targets constantly being reviewed, there is no shortage of organic growth potential already available in i3's portfolio. Indeed, the company recently hinted that some of these opportunities may be brought forward, in an expanded programme. Naturally, these targets compete for value for money with one another, and with opportunities within the M&A space.

In terms of our forecasts, we assume average FY22 production of 20,174 boepd, in line with company guidance of "above 20,000 boepd". From FY23 onwards, we have assumed that a handful of wells are drilled each year to offset the assumed 14% annual decline (c.2,825 boepd at current production rates), budgeting accordingly. Using broad-brushed assumptions, we assume that approximately US$28m of ongoing spend allows for ten new development wells per year, adding in the region of 3,000 boepd and holding group production broadly flat at around 20,000 boepd.

UK North Sea assets

Last year i3 announced that it has agreed indicative farm out terms in principle with prospective partners at Serenity. The deal was subject to the partners securing funding commitments, which were anticipated before the end of last year. While the transaction therefore is taking longer than hoped, the fact that the deal is evidently still alive at this point (there has been no RNS to suggest otherwise) is positive, and the recent announcement from neighbour Repsol, confirming that it expects to reach a final investment decision on the adjacent and potentially connected Tain field, only improves i3's chances of a farm out, in our view. This is further supported by the move in oil prices, which has vastly improved the risk reward metrics for appraisal drilling.

Financial forecasts and valuation

Having made the aforementioned tweaks to our model, we forecast FY22 gross revenues of US$262m, up 33% on our previous forecasts. This flows through on EBITDA margins of 53%, to US$139m – equivalent to a FY22 EV/EBITDA multiple of just 2.2x.

Budgeting for the US$47m capex programme, and allocating an additional US$4m for ongoing abandonment expense, we estimate c.US$88m of free cash flow for FY22. Assuming just 20% of FCF is paid out in dividends (the company's policy is to distribute up to 30%), we estimate total shareholder returns of US$17.6m for the year – equivalent to 1.15p/shr and a running yield of 6.2% at current prices. This still leaves over US$70m of cash building on the balance sheet over the course of the year. Our full financial forecasts are shown on page 5.

In terms of our DCF valuation, the tweaks to our model inputs – predominantly our commodity price assumption – have increased Core NAV by 36% to 30.5p/shr. Our risked Total NAV has increased by 32% to 37.3p/shr.

Peer Analysis

In a sector which is currently offering value across the board, i3 still stands out. Despite low geopolitical and operational risks, the company trades at around 2.2x FY22 EBITDA, well below the sector average of around 2.9x, and only bettered by the Kurdish operators Gulf Keystone and Genel Energy, plus Pharos and Serica Energy. Meanwhile, our forecast dividend payment in FY22 equates to a competitive dividend yield of around 6.2% at current prices, despite having sector-leading cover of 5x, providing ample scope for additional growth and enhanced returns.

Figure 3: Comps table

	MKT CAP US$M	NET DEBT US$M	EV US$M	2P MMBOE	PROD. BOEPD	EV/2P US$/BOE	EV/BOEPD US$/BOEPD	'22 EBITDA US$M	'22 EV/EBITDA X	DIVIDEND YIELD %
i3 Energy	**275.7**	**17**	**303**	**132.6**	**20,174**	**2.28**	**15,019**	**138.7**	**2.2**	**6.17%**
Gulf Keystone	648.2	(228)	402	404.0	37,440	0.99	10,727	300.1	1.3	8.98%
Genel Energy	560.9	(44)	509	117.0	31,710	4.35	16,063	279.4	1.8	8.92%
Pharos Energy	163.4	58	215	58.7	8,878	3.66	24,228	130.0	1.7	
Serica Energy	875.9	(297)	639	61.0	28,500	10.48	22,429	621.7	1.0	2.02%
Diversified En.	1236.4	633	1959	753.0	133,000	2.60	14,732	487.7	4.0	11.16%
Seplat	840.3	480	1274	499.0	48,000	2.55	26,547	467.0	2.7	7.91%
EnQuest	552.7	1,280	1815	189.0	45,000	9.60	40,328	939.2	1.9	
Savannah En.	488.8	370	840	183.1	38,600	4.59	21,766	320.0	2.6	1.55%
Harbour Oil	4433.2	2,350	6937	569.0	163,000	12.19	42,557	2983.0	2.3	4.43%
Capricorn En.	1640.5	(133)	1515	145.9	36,300	10.39	41,749	165.5	9.2	
Tullow Oil	1013.3	2,100	3102	260.0	59,200	11.93	52,398	1089.0	2.8	8.98%
					Average*	**6.67**	**28,502**		**2.9**	

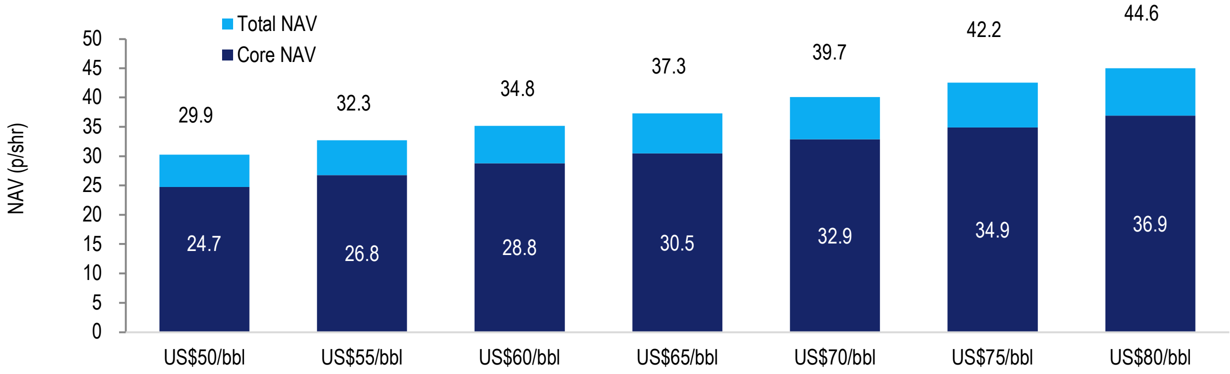
Source: Tennyson Securities, Bloomberg, prices as of 11/7/2022. *Average ex. i3.

Figure 4: 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**
Canada PDP reserves	n/a	n/a	50.4	6.1	306	17.5	100%	306	17.5
Canada 2P reserves	n/a	n/a	82.2	3.8	316	18.0	75%	237	13.5
Deduct: net cash*					(17)	(1.0)		(17)	(1.0)
Add: corporate items					8	0.4		8	0.4
Core NAV			**132.6**		**613**	**35.0**		**534**	**30.5**
Serenity	69.0	100%	69.0	13.85	955	54.5	13%	119	6.8
Total NAV			**201.6**		**1,568**	**89.5**		**653**	**37.3**

Valuation assumptions:
Brent price: US$86.1/bbl 2022, US$78.9/bbl 2023, US$75.0/bbl 2024, US$65.0 flat thereafter.
NGL price (at local sales point): 45% of Edmonton Light long term.
AECO gas price: US$3.2/mcf 2022, US$2.79/mcf 2023, US$2.49/mcf 2024, US$2.55/mcf flat thereafter.
Discount rate 10%.
1.36 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 (2022 onwards):



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

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	**12,912**	**20,174**	**20,450**	**20,687**
Average realised price	US$/boe	19.0	31.4	35.6	31.9	29.8
Net gas volumes	mmscf/d	9.8	42.5	61.6	63.2	64.6
Gas revenue	**US$m**	8.6	**48.0**	**72.0**	**64.4**	**58.7**
Net NGL volumes	bpd	843	3,630	6,150	6,064	5,990
NGL revenue	**US$m**	4.8	**38.1**	**78.9**	**70.6**	**65.9**
Net oil volumes	bopd	517	2,207	3,750	3,845	3,927
Oil revenue	**US$m**	7.1	**58.0**	**106.9**	**99.4**	**96.0**
Revenue	**US$m**	20.8	**141.2**	**261.8**	**238.4**	**224.7**
Operating costs (inc. royalties)	US$m	(12.1)	(84.7)	(107.2)	(105.1)	(104.2)
Unit	*US$/boe*	*(11.1)*	*(18.0)*	*(14.6)*	*(14.1)*	*(13.8)*
G&A costs	US$m	(7.8)	(16.0)	(16.0)	(16.0)	(16.0)
Unit	*US$/boe*	*(7.2)*	*(3.4)*	*(2.2)*	*(2.1)*	*(2.1)*
EBITDA	**US$m**	0.8	**40.5**	**138.7**	**117.3**	**104.5**
EBITDA margin	*US$/boe*	*4.0%*	*28.7%*	*53.0%*	*49.2%*	*46.5%*
DD&A	US$m	(6.6)	(28.5)	(44.5)	(45.1)	(45.6)
Finance and other expenses	US$m	24.3	(9.4)	(8.1)	(9.1)	(9.7)
Profit before tax	**US$m**	18.5	**2.5**	**86.1**	**63.1**	**49.2**
Income tax	US$m	1.5	-	-	(8.4)	(15.9)
Net income	**US$m**	20.0	**2.5**	**86.1**	**54.6**	**33.3**
Adjusted EPS (fully diluted)	c/shr	*1.6*	*0.2*	*6.7*	*4.2*	*2.6*
Profit before tax	**US$m**	18.5	**2.5**	**86.1**	**63.1**	**49.2**
Cash flow reconciliation	US$m	17.2	37.7	52.6	54.2	55.3
Working capital movements	US$m	(3)	-	-	-	-
Interest paid, net	US$m	(0.2)-	-	-	-	-
Tax paid	US$m	0.5-	-	-	(5.9)	(15.9)
Net operating cash flow	**US$m**	(1.2)	**40.2**	**138.7**	**111.4**	**88.6**
Cash flow margin	*US$/boe*	*(1.1)*	*8.5*	*18.8*	*14.9*	*11.7*
Capex (including A&D)	US$m	(24.2)	(18.3)	(50.5)	(32.0)	(32.0)
Free cash flow	**US$m**	(25.4)	**21.9**	**88.2**	**79.4**	**56.6**
Dividend pay-out	US$m	-	(4.7)	(17.6)	(17.6)	(17.6)
Acquisitions/divestments	US$m	(24.8)	(54.0)	-	-	-
Debt movement, other	US$m	-	-	-	-	-
Share issuance	US$m	37.1	53.0	-	-	-
Net increase (decrease) in cash	**US$m**	(13.1)	**16.2**	**70.5**	**61.7**	**39.0**
Cash	US$m	8.4	24.6	95.1	156.9	195.9
Other current assets	US$m	11.9	11.9	11.9	11.9	11.9
O&G assets	US$m	214.4	256.3	258.2	241.1	223.5
Total assets	**US$m**	234.7	**292.8**	**365.3**	**409.9**	**431.2**
Debt	US$m	37.7	41.9	46.5	51.6	57.3
Other liabilities & decommissioning	US$m	111.4	112.6	112.1	112.1	112.1
Shareholder equity	US$m	99.8	152.4	220.8	260.4	276.0
Total equity & liabilities	**US$m**	248.8	**306.9**	**379.4**	**424.0**	**445.3**
P/E - adjusted, fd	*x*	-	*112.9x*	*3.3x*	*5.0x*	*8.6x*
EV/EBITDAX	*x*	-	*7.8x*	*2.2x*	*2.0x*	*1.7x*
Dividend paid	*c/shr*	-	*0.42*	*1.57*	*1.57*	*1.57*
Dividend yield	*%*	-	*1.6%*	*6.2%*	*6.2%*	*6.2%*
Dividend cover	*x*	-	*4.6x*	*5.0x*	*4.5x*	*3.2x*
FCF yield	*%*	-	*7.7%*	*30.9%*	*27.8%*	*19.8%*
Net debt /EBITDA	*x*		*0.7x*	*0.1x*	-	-

Source: Tennyson Securities.

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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
11 February 2022	1384.6	18.65	30.5	BUY

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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.

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