

# i3 Energy (I3E LN)

## MARKET DATA

Bloomberg	ticker	I3E LN
Share price	p/shr	24.7
Target	p/shr	50.0
TP upside	%	102%
Shares out	Million	1.192.7
Fd shares	Million	1,225.3
Mkt cap	US\$m	338.8
EV	US\$m	353.3

## DESCRIPTION

i3 Energy is a Canadian focussed oil and gas producer. It has a large acreage position across the Western Canadian Sedimentary Basin, where it generates sufficient cash flow to pay a healthy dividend yield, as well as to fund production growth and exploration activities. i3 also has a 75% stake in the UK North Sea Serenity discovery, on which appraisal drilling is soon to commence.

## MAKING HAY

**i3 Energy recently announced that it has surpassed 21.5 kboepd of balanced oil, gas and NGL production onshore Canada. The company has timed the cycle impeccably, acquiring a suite of assets when industry prices were at an all-time low and now reaping the benefits of recovered energy prices. Through development drilling and other activities, i3 has been able to grow production organically this year; up over 25% from December's exit rate and more than offsetting the lower-than-expected natural decline on base production, which is running at c.11.5% (vs. the CPR audited forecast of c.14%). This year's exceptional cash flows have allowed the company to double its development drilling budget for the year, accelerating the monetization of the substantial landbank of PUD reserves. Having updated our numbers to reflect the latest oil and gas price strip, as well as the latest production guidance and drilling plans, we believe that i3 offers substantial value on current cash flow metrics alone, trading at just 2.2x FY23 EBITDA and on a dividend yield of c.7% - crucially covered 4.5 times by FY23 free cash flow (on a blowdown basis). In addition, with inorganic and organic growth potential, and the imminent material, drilling catalyst of the Serenity appraisal well in the coming weeks, we believe that today's 24.7p/shr is an attractive entry point, and carry a near term target price of 50p/shr – offering over 100% upside from today's level.**

Figure 1: Summary financial forecasts

		2021	2022	2023	2024
<b>Production, net</b>	<b>kboepd</b>	12,442	20,188	20,967	21,131
Av. price*	US\$/boe	28.3	40.1	39.9	34.0
Revenue	US\$m	128.4	295.2	305.0	262.4
<b>EBITDA</b>	<b>US\$m</b>	41.6	149.7	159.9	122.1
<i>Margin</i>	<i>%</i>	32%	51%	52%	47%
<b>FCF <sup>†</sup></b>	<b>US\$m</b>	11.5	23.8	105.9	66.1
<i>FCF yield</i>	<i>%</i>	-	7.0%	31.2%	19.5%
<i>Dividend yield*</i>	<i>%</i>	0.0%	5.0%	6.9%	6.9%
<i>FCF / dividend (cover)</i>	<i>x</i>	-	1.4x	4.5x	2.8x
<i>Net debt / EBITDA</i>	<i>x</i>	-	0.1x	0.0x	-

Source: Tennysen Securities. \*Blended average, hedged. <sup>†</sup>Net cash flow, post capex, pre dividend. \*Paid yield.

**Q2 numbers:** The recently announced Q2 update illustrated further organic production growth, with output rising 8% (quarter on quarter) to 19,502 boepd. This was predominantly driven by strong underlying production and the impact of drilling in Q1. Impressively, production would be higher were it not for curtailments at a third-party midstream facility, and for development activities at Simonette, which required well shut-ins to enable new drilling and completions. Full production has now been restored, reaching the 20,000 boepd milestone at the end of July, and currently around the 21,600 boepd mark.

As announced in May, i3 has expanded its capex budget for the year, accelerating drilling across its portfolio and reinvesting an anticipated US\$97m. Seasonal wet weather has caused a few delays to the planned deployment, however the programme is now progressing well, with several wells recently tied in. These include three long lateral, liquids-rich Glauconite wells, which are in the clean-up phase and demonstrating “encouraging initial results”. With this in mind, i3 has recently reiterated its expectation to deliver peak 2022 production of over 24,000 boepd during the second half of the year.

Given the global market conditions, there has inevitably been an element of cost inflation, with current forecasts for the full year approximately 3% higher than those at the start of the year. With current inflation rates running at around c.8% in Canada, the 3% rise infers an element of

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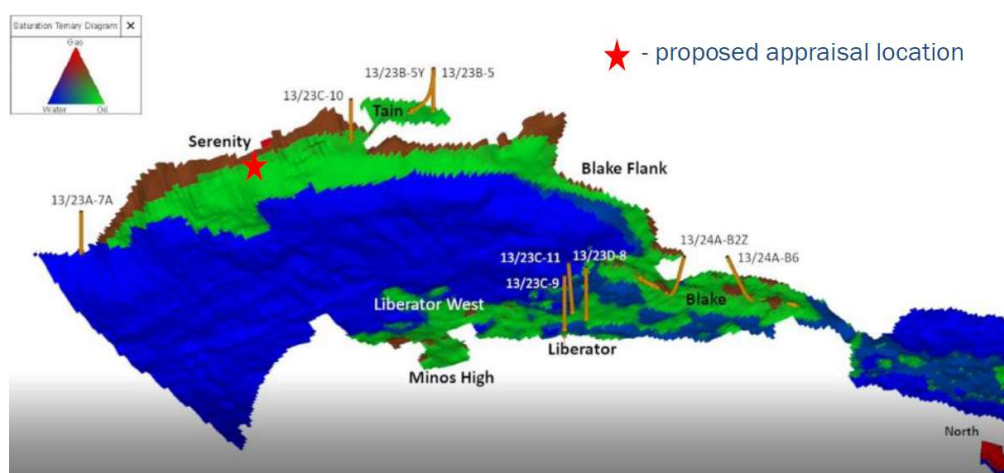
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relative cost cutting across the portfolio, however we would expect the company to continue to seek opportunities to trim costs. For reference, our modelling assumes unit operating costs this year of US\$11.5/boe, which is equivalent to US\$84.7m and slightly above the realised unit costs for FY21 of US\$11.1/boe (see Financials on page 5). A 3% rise on our FY22 forecast would add around US\$2.5m to the budget for the year.

**Serenity imminent:** The North Sea appraisal well at Serenity is due to spud imminently, with the Stena Don semi-sub expected onsite in the coming days. The highly anticipated well is targeting a westerly extension of the c.16 mmbbls low case STOIP discovered by well 13/23C-10 in 2019. The new appraisal well lies between the discovery well, which found light oil within a relatively thin sand package (11ft true vertical thickness), and a water-wet well (13/23A-7A) approximately 8km to the west, with an equivalent c.100ft thick reservoir section. A success case would see a happy medium, with the reservoir thickness somewhere between the two, but still above the oil/water contact (as in Figure 2, below). Partner Europa Oil & Gas has suggested that if the net oil column at the appraisal well location underpins a possible average 40ft thickness across the reservoir, this would support the P50 case of 197 mmbbls STOIP (68 mmbbls recoverable using a 35% recovery factor). It is expected to take c.30 days to reach TD, implying results in the second half of October.

**Figure 2: Serenity structure and appraisal well location**



Source: Europa Oil & Gas

**ESG report:** In June i3 published its first ESG report, a comprehensive document covering the key ESG issues affecting the company. The report included the company's first emissions intensity data, with Scope 1&2 emissions totalling 36.4 kgCO<sub>2</sub>e/boe for the year 2020 (note this does not include the Cenovus assets, which were acquired in August 2021 and will be included in its next sustainability report). This is substantially below the average for Canadian conventional production, which is at 48.1 kgCO<sub>2</sub>e/bbl for oil and 42.0 kgCO<sub>2</sub>e/boe for gas. Still, i3 identified room for improvement, and has replaced virtually all of its high-bleed pneumatic controllers with low-bleed models resulting in significant reductions in methane emissions, and has commenced a programme of well site electrifications and solar powered chemical injection pump installations. The work that the company has completed to date has already reduced emissions by 28 ktCO<sub>2</sub>e in 2021 – equivalent to 34% of the company's total 2020 output. The report goes on to outline the company's plans going forward, including expanding the strategy to include baseline water usage as well as a biodiversity statement. Going forwards, the company has committed to forming a corporate ESG committee to provide continual oversight on the company's activities, helping to identify and address any issues before they escalate, and setting the company in good stead for further growth.

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**Valuation and Financial update:** We have taken the opportunity to update our numbers, accounting for the latest reserve estimates and production figures, cost inflation, as well as updating strip prices through to end 2025 (NB our long-term commodity price forecasts remain unchanged at US\$65/bbl and US\$2.55/mcf). These changes, plus the weakening pound against the dollar, have increased our PDP and 2P NAV by a combined 21.25p/shr. After adjusting for net cash, plus in-the-money options and warrants, this results in a Core NAV of 51.4p/shr. With respect to Serenity, we attribute a further 17.5p/shr of risked value after applying a commercial chance of success of 25% (including a geological risking of around 50%). This takes risked Total NAV to 68.9p/shr.

In terms of cash flow, we expect revenue to reach around US\$300m this year, with EBITDAX at c.US\$150m on a 51% margin. Capex totals US\$110m, which includes the US\$97m budget for Canadian operations, plus drilling at Serenity and other costs, leading to US\$24m of free cash flow for the full year. From this, i3 has committed to paying out “not less” than £14.78m (US\$17.14m) in dividends. Cash generation in our model is much stronger in 2023, with over US\$105m of free cash flow forecasted. This results from the full benefit of the 2022 enhanced drilling campaign, and our modelling of capital deployment, which assumes sufficient development drilling to hold production flat, rather than the more substantial campaign that resulted in strong growth this year.

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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	60.1	6.4	386	27.4	100%	386	27.4	
Canada 2P reserves	n/a	n/a	94.0	5.0	467	33.2	75%	350	24.9	
Deduct: net cash*					(15)	(1.0)		(15)	(1.0)	
Add: corporate items					2	0.2		2	0.2	
<b>Core NAV</b>			<b>154.1</b>		<b>841</b>	<b>59.7</b>		<b>724</b>	<b>51.4</b>	
Serenity	69.0	75%	51.7	19.07	986	70.0	25%	247	17.5	
<b>Total NAV</b>			<b>205.8</b>		<b>1,827</b>	<b>129.6</b>		<b>970</b>	<b>68.9</b>	

**Valuation assumptions:**

Brent price: US\$101.7/bbl 2022, US\$85.0/bbl 2023, US\$78.7.0/bbl 2024, US\$74.3/bbl 2025 US\$65.0 flat thereafter.

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

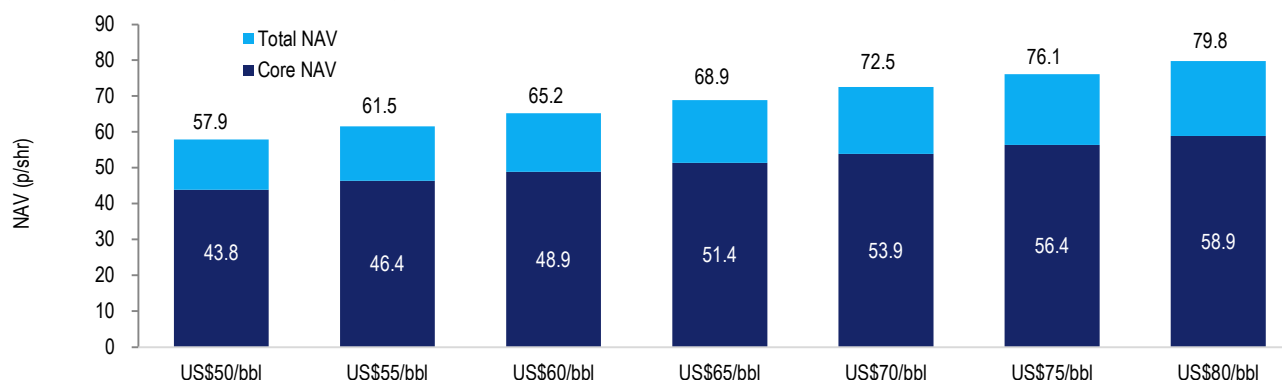
AECO gas price: US\$4.71/mcf 2022, US\$4.7/mcf 2023, US\$3.5/mcf 2024, US\$2.55/mcf flat thereafter.

Discount rate 10%.

1.15 US dollar / sterling.

1,193m ordinary shares outstanding. 32.5m options and warrants outstanding with exercise prices 0.01p-11p/shr.

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



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

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

FYE 31ST DEC		2020	2021E	2022E	2023E	2024E
<b>Net oil &amp; gas production</b>	<b>boepd</b>	<b>2,998</b>	<b>12,442</b>	<b>20,188</b>	<b>20,967</b>	<b>21,131</b>
Average realised price	US\$/boe	20.0	32.6	45.1	39.9	34.0
Net gas volumes	mmscf/d	9.8	42.5	64.8	67.6	68.4
<b>Gas revenue</b>	<b>US\$m</b>	<b>8.6</b>	<b>48.0</b>	<b>111.5</b>	<b>115.9</b>	<b>87.3</b>
Net NGL volumes	bpd	843	3,630	5,526	5,666	5,648
<b>NGL revenue</b>	<b>US\$m</b>	<b>5.9</b>	<b>38.1</b>	<b>85.0</b>	<b>71.7</b>	<b>65.6</b>
Net oil volumes	bopd	517	2,207	3,856	4,033	4,088
<b>Oil revenue</b>	<b>US\$m</b>	<b>7.1</b>	<b>58.0</b>	<b>131.8</b>	<b>113.4</b>	<b>105.5</b>
<b>Revenue*</b>	<b>US\$m</b>	<b>18.8</b>	<b>128.4</b>	<b>295.2</b>	<b>305.0</b>	<b>262.4</b>
Operating costs (inc. royalties)	US\$m	(12.1)	(68.8)	(127.4)	(127.1)	(122.3)
<i>Unit</i>	<i>US\$/boe</i>	<i>(11.1)</i>	<i>(15.2)</i>	<i>(17.3)</i>	<i>(16.6)</i>	<i>(15.9)</i>
G&A costs	US\$m	(7.8)	(18.0)	(18.0)	(18.0)	(18.0)
<i>Unit</i>	<i>US\$/boe</i>	<i>(7.2)</i>	<i>(4.0)</i>	<i>(2.4)</i>	<i>(2.4)</i>	<i>(2.3)</i>
<b>EBITDA</b>	<b>US\$m</b>	<b>(1.1)</b>	<b>41.6</b>	<b>149.7</b>	<b>159.9</b>	<b>122.1</b>
<i>EBITDA margin</i>	<i>US\$/boe</i>	<i>(6.1%)</i>	<i>32.4%</i>	<i>50.7%</i>	<i>52.4%</i>	<i>46.5%</i>
DD&A	US\$m	(6.6)	(29.8)	(46.5)	(48.3)	(48.7)
Finance and other expenses	US\$m	21.8	19.2	(6.3)	(6.8)	(6.8)
<b>Profit before tax</b>	<b>US\$m</b>	<b>14.0</b>	<b>31.0</b>	<b>96.9</b>	<b>104.7</b>	<b>66.5</b>
Income tax	US\$m	1.5	(0.9)	(13.4)	(19.2)	(21.1)
<b>Net income</b>	<b>US\$m</b>	<b>15.5</b>	<b>30.1</b>	<b>83.4</b>	<b>85.5</b>	<b>45.4</b>
Adjusted EPS (fully diluted)	c/shr	1.3	2.5	6.8	7.0	3.7
<b>Profit before tax</b>	<b>US\$m</b>	<b>14.0</b>	<b>31.0</b>	<b>96.9</b>	<b>104.7</b>	<b>66.5</b>
Cash flow reconciliation	US\$m	(17.2)	10.2	52.9	55.2	55.6
Working capital movements	US\$m	(3.0)	(12.0)	-	-	-
Interest paid, net	US\$m	(0.2)	(0.7)	(2.8)	(2.8)	(2.8)
Tax paid	US\$m	0.5	0.7	(13.4)	(19.2)	(21.1)
<b>Net operating cash flow</b>	<b>US\$m</b>	<b>(5.8)</b>	<b>29.2</b>	<b>133.5</b>	<b>137.9</b>	<b>98.1</b>
<i>Cash flow margin</i>	<i>US\$/boe</i>	<i>(5.3)</i>	<i>6.4</i>	<i>18.1</i>	<i>18.0</i>	<i>12.7</i>
Capex (including A&D)	US\$m	(24.2)	(17.7)	(109.7)	(32.0)	(32.0)
<b>Free cash flow</b>	<b>US\$m</b>	<b>(30.0)</b>	<b>11.5</b>	<b>23.8</b>	<b>105.9</b>	<b>66.1</b>
Dividend pay-out	US\$m	-	(4.7)	(17.0)	(23.5)	(23.5)
Acquisitions/divestments	US\$m	(24.8)	(51.0)	-	-	-
Share issuance	US\$m	37.1	52.4	-	-	-
<b>Net increase (decrease) in cash</b>	<b>US\$m</b>	<b>(17.7)</b>	<b>8.2</b>	<b>6.8</b>	<b>82.4</b>	<b>42.6</b>
Cash	US\$m	8.4	21.1	27.8	110.2	152.9
Other current assets	US\$m	11.9	35.1	35.1	35.1	35.1
O&G assets	US\$m	214.4	376.7	435.9	415.6	394.8
<b>Total assets</b>	<b>US\$m</b>	<b>234.7</b>	<b>432.9</b>	<b>498.8</b>	<b>560.9</b>	<b>582.8</b>
Debt	US\$m	37.7	35.6	35.6	35.6	35.6
Other liabilities & decommissioning	US\$m	111.4	197.3	196.8	196.8	196.8
Shareholder equity	US\$m	99.8	190.0	256.5	318.5	340.5
<b>Total equity &amp; liabilities</b>	<b>US\$m</b>	<b>248.8</b>	<b>422.9</b>	<b>488.8</b>	<b>550.9</b>	<b>572.8</b>
<i>P/E - adjusted, fd</i>	<i>x</i>	<i>-</i>	<i>-</i>	<i>4.1x</i>	<i>4.0x</i>	<i>7.5x</i>
<i>EV/EBITDAX</i>	<i>x</i>	<i>-</i>	<i>-</i>	<i>2.4x</i>	<i>2.2x</i>	<i>2.2x</i>
<i>Dividend paid</i>	<i>c/shr</i>	<i>-</i>	<i>-</i>	<i>1.43</i>	<i>1.97</i>	<i>1.97</i>
<i>Dividend yield</i>	<i>%</i>	<i>-</i>	<i>-</i>	<i>5.0%</i>	<i>6.9%</i>	<i>6.9%</i>
<i>Dividend cover</i>	<i>x</i>	<i>-</i>	<i>-</i>	<i>1.4x</i>	<i>4.5x</i>	<i>2.8x</i>
<i>FCF yield</i>	<i>%</i>	<i>-</i>	<i>-</i>	<i>7.0%</i>	<i>31.2%</i>	<i>19.5%</i>

Source: Tennyson Securities. \*Revenue net of hedging 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
11 February 2022	1384.6	18.65	30.5	BUY
15 September 2022	1275.4	24.7	50.0	BUY

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