i3 Energy (I3E LN)

MARKET DATA

Bloomberg	ticker	I3E LN
Share price	p/shr	13.6
Target	p/shr	35.0
TP upside	%	157%
Shares out	Million	1,201.9
Fd shares	Million	1,242.3
Mkt cap	US$m	206.3
EV	US$m	214.3

DESCRIPTION

i3 Energy is a Canadian focussed oil and gas producer. It has a large acreage position across the Western Canadian Sedimentary Basin. The company looks to strike a balance between re-investing for growth and paying out dividends to shareholders.

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TURNING POINT

i3 Energy has had a relatively challenging year to date, with weak commodity prices coinciding with both scheduled and unscheduled downtimes across the company's infrastructure. Nevertheless, despite these temporary setbacks the company has been able to continue on its organic growth trajectory, with full year production forecast to average 20-21,000 boepd (vs. 20,317 boepd in 2022) thanks to a number of successful development wells. Furthermore, with oil and gas prices showing signs of a strong recovery, i3 is well placed to enjoy a strong second half of the year. Our updated numbers forecast FY23 EBITDA of US$84m, comfortably covering this years' capital budget (US$25m) and dividend payout (US$19m). At the current share price of 13.6p/shr, i3 offers a sustainable dividend yield of around 7.5%, with excess cash flow deleveraging the business, and allowing for growth, either at the drill-bit or through M&A. With North American natural gas markets tightening as winter approaches, we see the recent share price weakness as an opportunistic buying opportunity. We update our Target Price to 35p/shr, broadly set at our NPV10 of the company's 2P reserve base, offering 157% upside from current levels.

Figure 1: Summary financial forecasts

		2022	2023	2024	2025
Production, net	**kboepd**	19,887	**20,209**	**20,636**	**20,998**
Av. price*	US$/boe	38.0	30.4	29.3	31.6
Revenue	US$m	275.8	224.2	220.5	242.5
EBITDA	**US$m**	121.2	**84.1**	**78.4**	**95.5**
Margin	*%*	*44%*	*37%*	*36%*	*39%*
FCF ϕ	**US$m**	25.5	**32.0**	**36.0**	**46.3**
FCF yield	*%*	-	*15.5%*	*17.5%*	*22.5%*
Dividend yield+	*%*	-	*10.0%*	*7.5%*	*7.5%*
FCF / dividend (cover)	*x*	*1.3x*	*1.6x*	*2.3x*	*3.0x*
EV / EBITDA	*x*	-	*2.2x*	*2.7x*	*2.0x*

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

Operations update: The weaker than anticipated Canadian gas prices and WTI pricing in the first half of the year led i3 to the drawing board, with the company scaling back its annual capex budget and dividend payout. This cut allowed the company to meet its commitments even in its downside scenario, which amongst other things included a 15% reduction in strip prices from the low earlier this year. As it happened, almost as soon as i3 took these measures forward WTI strip prices started recovering, making the approach look particularly cautious. Still, as a result the company is left in a financially robust position, with new optionality when it comes to capital allocation.

In terms of operations, i3 averaged 20,640 boepd during H1, impacted by the loss of 3,100 boepd over Q2 due to restrictions associated with regional wildfires and scheduled, and unscheduled maintenance work. These issues were largely resolved by July, with the company recording average production over the month of 22,065 boepd (split 4,597 bbl/d oil and condensate, 5,490 bbl/d NGL and 69.5 mmscf/d gas).

Development drilling during the year to date has focused on oil and liquids rich regions – including Central Alberta, Wapiti and Clearwater. A total of eight wells were drilled and brought onstream, helping to mitigate natural decline from base production (last quoted at 17% per annum). A further six wells may be drilled in the second half of the year, potentially focused in the liquids rich Clearwater area, where wells are inexpensive to drill and returns are high (rates of return at US$75/bbl oil prices are in the region of 364%). All-in, the 14 wells are expected to peak at an incremental 1,500 boepd of production.

With strip prices improving, and the downside scenario (which prompted the reduced capex and dividend budgets) averted, we expect i3 to once again accelerate development drilling once the 2024 budget is announced. The original budget for 2023 included an additional nine wells (on top of the 14), which we would now expect to be drilled during H1 next year. Saying this, i3 is not short on drilling locations, with a total inventory of 940 development locations, of which 376 are currently booked. These locations include both gas and liquids rich, type curves ranging from IP rates of 200 to >1,000 boepd, and with returns on investment from 58% through to 400% at US$75/bbl oil and C$3/GJ gas prices.

Debt restructured: Over the course of the first half of the year, i3 settled its outstanding £22m of loan notes in full. Concurrently, the company signed a new C$100m, three-year debt facility with Trafigura Canada. This new facility is structured with an initial C$75m advance, and a further C$25m accordion facility.. The facility pays a fixed coupon of 9.5% per annum, and amortises on a monthly basis, meaning a relatively aggressive pace of deleveraging and relatively modest interest payments (interest paid only on the outstanding).

Serenity: Earlier in October, Repsol Sinopec announced that it had allowed the licence containing the Tain oil discovery to lapse, describing the project as “no longer …active”. As recently as last year, Repsol Sinopec was talking about preparing for a final investment decision on a 10 mmbbls development, which would see initial production rates of 8,000 bopd. Following i3’s Serenity discovery (c.7 mmbbls recoverable), which is adjacent to Tain, the partners have been investigating options for a joint development, with obvious economies of scale improving the economics of both projects. The exit of RSRUK and its partner Viaro opens the door for i3 to apply for a new licence on Tain, with a view to working up a fresh, consolidated development plan. With i3 being the obvious candidate for Tain, we believe that there is a good chance of an award outside the normal periodic licencing rounds. We would consider such an award a real boost for the chances of monetizing the two discoveries.

H1 numbers and forecasts: during H1 i3 delivered revenue of US$92m and adjusted EBITDAX of US$47m (including hedging gains, which amounted to around US$4m). Capex amounted to around US$20m, which included eight new development wells, infrastructure upgrades and maintenance costs. After accounting for working capital adjustments (phased payments included in last year’s drilling budget), cash finance costs and taxes, free cash flow was marginally negative at c.US$3.5m.

In terms of full year forecasts, we expect i3 to record revenue of US$195m (net of royalties and hedges) and EBITDAX of US$84m. Capex is front half loaded for the year, resulting in free cash flow (before dividends and movement in debt) of c.US$32m. Next year we forecast EBITDAX of US$78.4m (on Brent oil prices of US$78.5/bbl and AECO gas prices of US$2.15/mcf), rising to US$95.5m in 2025, driven predominantly by the rising strip gas prices (assumed average of US$2.74/mcf). Debt amortises on a straight line at US$18.5m per annum, with a sustainable dividend totalling US$15.5m (1.03p/shr) and cash building on the balance sheet.

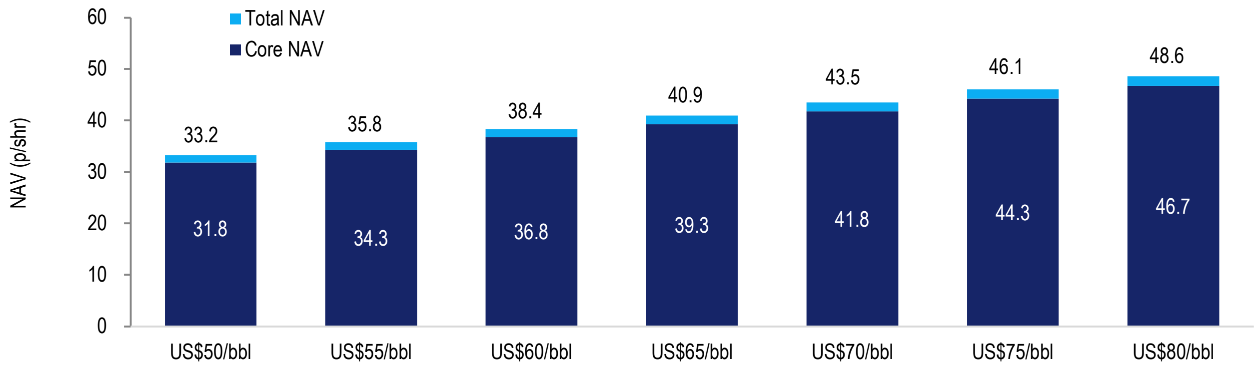
At today’s share price of 13.6p/shr, i3 shares offer a running dividend yield of 7.5%, covered more than 2x by free cash flow. The solid levels of cash flow is comfortably amortising the outstanding debt over the next three years, with surplus available in our forecasts to upscale the drilling programme, or pursue M&A opportunities should they arise. Continuing strength in local gas prices will further improve the financial standing of the company and could open up the possibility of enhanced returns, for example in the form of share buybacks or special dividends. We value i3 on a risked Core NAV of 37p/shr, including PDP reserves of 9.5p/shr, and 2P reserves of 40.2p/shr (see NAV table below). This forms the basis of our Target Price of 35p/shr.

Figure 4: Valuation summary table

NET ASSET VALUE									
Asset	**Gross mmboe**	**Interest**	**Net mmboe**	**US$/boe**	**Unrisked US$m**	**p/shr**	**CoS**	**Risked US$m**	**p/shr**
Canada PDP reserves	n/a	n/a	49.1	3.0	149	9.5	100%	149	9.5
Canada 2P reserves	n/a	n/a	132.4	4.8	640	40.9	75%	480	30.7
Deduct: net cash*					(8)	(0.5)		(8)	(0.5)
Deduct: 3yr G&A					(45)	(2.9)		(45)	(2.9)
Add: corporate items					3	0.2		3	0.2
Core NAV			**181.5**		**739**	**47.2**		**579**	**37.0**
Serenity	7.0	75%	5.3	19.52	102	6.5	25%	26	1.6
Total NAV			**186.8**		**841**	**53.7**		**604**	**38.6**

Valuation assumptions:
Brent price: US$82.5/bbl 2023, US$78.5/bbl 2024, US$74.6/bbl 2024, US$71.9/bbl 2025 US$65.0 flat thereafter.
NGL price (at local sales point): 40% of Edmonton Light long term.
AECO gas price: US$1.99/mcf 2023, US$2.15/mcf 2024, US$2.74/mcf 2025, US$2.55/mcf flat thereafter.
Discount rate 10%.
1.26 US dollar / sterling.
1,201m ordinary shares outstanding. 40.5m 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 YE23.

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

FYE 31ST DEC		2021	2022	2023E	2024E	2025E
Net oil & gas production	**boepd**	12,442	19,887	**20,209**	**20,636**	**20,998**
Average realised price	US$/boe	28.3	45.1	29.4	29.3	31.6
Net gas volumes	mmscf/d	42.5	63.0	66.0	67.1	67.9
Gas revenue	**US$m**	**48.0**	**96.1**	**47.9**	**52.7**	**68.0**
Net NGL volumes	bpd	3,630	5,046	4,750	5,015	5,243
NGL revenue	**US$m**	**38.1**	**77.6**	**34.7**	**39.6**	**52.8**
Net oil volumes	bopd	2,207	4,337	4,458	4,444	4,433
Oil revenue	**US$m**	**58.0**	**139.8**	**120.2**	**114.4**	**107.7**
Revenue*	**US$m**	**128.4**	**275.8**	**224.2**	**220.5**	**242.5**
Operating costs (inc. royalties)	US$m	(68.8)	(136.0)	(125.1)	(127.0)	(131.8)
Unit	*US$/boe*	*(15.2)*	*(18.7)*	*(17.0)*	*(16.9)*	*(17.2)*
G&A costs	US$m	(18.0)	(18.6)	(15.1)	(15.1)	(15.1)
Unit	*US$/boe*	*(4.0)*	*(2.6)*	*(2.0)*	*(2.0)*	*(2.0)*
EBITDA	**US$m**	**41.6**	**121.2**	**84.1**	**78.4**	**95.5**
EBITDA margin	*US$/boe*	*32.4%*	*43.9%*	*37.5%*	*35.5%*	*39.4%*
DD&A	US$m	(29.8)	(42.5)	(43.2)	(44.1)	(44.8)
Finance and other expenses	US$m	23.6	(9.7)	(12.5)	(5.3)	(4.4)
Profit before tax	**US$m**	**35.4**	**69.0**	**28.4**	**29.0**	**46.2**
Income tax	US$m	(0.9)	(17.1)	(6.9)	(14.6)	(13.1)
Net income	**US$m**	**34.5**	**51.9**	**21.5**	**14.4**	**33.2**
Adjusted EPS (fully diluted)	c/shr	*2.8*	*4.2*	*1.7*	*1.2*	*2.7*
Profit before tax	**US$m**	**35.4**	**69.0**	**28.4**	**29.0**	**46.2**
Cash flow reconciliation	US$m	10.2	52.6	55.7	49.4	49.3
Working capital movements	US$m	(12.0)	3.4	(7.7)	-	-
Interest paid, net	US$m	(0.7)	(3.0)	(4.8)	(1.3)	(0.4)
Tax paid	US$m	0.7	-	(8.0)	(6.9)	(14.6)
Net operating cash flow	**US$m**	**33.6**	**122.1**	**63.5**	**70.2**	**80.5**
Cash flow margin	*US$/boe*	*7.4*	*16.8*	*8.6*	*9.3*	*10.5*
Capex (including A&D)	US$m	(17.7)	(96.5)	(31.5)	(34.1)	(34.1)
Free cash flow	**US$m**	**15.9**	**25.5**	**32.0**	**36.0**	**46.3**
Dividend pay-out	US$m	(4.7)	(19.0)	(20.6)	(15.5)	(15.5)
Acquisitions/divestments	US$m	(51.0)	(0.7)	-	-	-
Movement in debt, other	US$m	-	(4.4)	8.6	(18.4)	(18.4)
Share issuance	US$m	52.4	-	-	-	-
Net increase (decrease) in cash	**US$m**	**12.6**	**1.5**	**20.0**	**2.1**	**12.4**
Cash	US$m	21.1	20.5	40.5	42.6	55.0
Other current assets	US$m	35.1	43.1	43.1	43.1	43.1
O&G assets	US$m	376.7	369.2	357.1	346.6	335.4
Total assets	**US$m**	**432.9**	**432.8**	**440.7**	**432.3**	**433.5**
Debt	US$m	35.6	2.5	48.5	30.1	11.7
Other liabilities & decommissioning	US$m	197.3	180.6	176.3	179.8	183.2
Shareholder equity	US$m	190.0	203.8	204.6	202.5	221.2
Total equity & liabilities	**US$m**	**422.9**	**386.9**	**429.5**	**413.4**	**416.2**
P/E - adjusted, fd	*x*	-	-	*9.6x*	*14.3x*	*6.2x*
EV/EBITDAX	*x*	-	-	*2.2x*	*2.7x*	*2.0x*
Dividend paid	*c/shr*	*0.39*	*1.58*	*1.72*	*1.29*	*1.29*
Dividend yield	*%*	-	-	*10.0%*	*7.5%*	*7.5%*
Dividend cover	*x*	*3.4x*	*1.3x*	*1.6x*	*2.3x*	*3.0x*
FCF yield	*%*	-	-	*15.5%*	*17.5%*	*22.5%*

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
12 October 2023	702.4	13.6	35.0	BUY

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

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