

i3 Energy (I3E LN)

MARKET DATA

Bloomberg	ticker	I3E LN
Share price	p/shr	8.30
Target	p/shr	16.0
TP upside	%	93%
Shares out	Million	722.4
Fd shares	Million	841.1
Mkt cap	US\$m	83.3
EV	US\$m	107.1

HIT THE GROUND RUNNING

i3 Energy has enjoyed a good start to life as a full-fledged producer. The company has successfully completed the integration of c.9,000 boepd of Canadian oil and gas production purchased over the course of 2020, and announced its maiden dividend in Q1 2021 as promised. Since taking ownership, the assets have outperformed CPR expectations by over 10%, and the company plans to bring a new well onstream before the end of this quarter with c.500 boepd of net production. Oil prices have also outperformed expectations – we forecasted 2021 Brent oil prices of just US\$45/bbl at the time of the acquisition, versus our current forecast of US\$60/bbl, vastly improving i3's entry price (to just 1x FY21 field level cash flow). With the stock already offering a 7.7% running yield (c.2x covered by FCF), and further accretion possible on the back of organic and acquisitive growth, we initiate coverage with a BUY recommendation and a 16p/shr target price.

Figure 1: Summary financial forecasts

		2021	2022	2023
Production, net	kboepd	8,980	8,382	7,919
Av. price*	US\$/boe	23.1	23.2	24.4
Revenue	US\$m	75.9	71.1	70.4
EBITDA	US\$m	22.4	20.6	22.0
Margin	%	30%	29%	31%
FCF ^φ	US\$m	13.8	10.2	11.6
FCF yield	%	16.6%	12.3%	14.0%
Dividend yield*	%	5.9% ⁺	7.7% ⁺	7.7% ⁺
FCF / dividend (cover)	x	2.8x	1.6x	1.8x
Net debt / EBITDA	x	1.1x	0.9x	0.9x

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

Strong operational performance: Over the three-month period ending 31 March 2021, production averaged 8,856 boepd (c.40% liquids), which was some 10% higher than CPR expectations, despite inclement weather conditions over the period. Production is expected to receive a near-term boost with the imminent tie in of the Noel Falher well in Northeast British Columbia. i3 expects the well to come onstream at sustainable rates in the region of 500 boepd, with first gas expected next month. This will boost group output by nearly 6%, and illustrates the potential for organic growth within i3's portfolio.

Clearwater growth: i3 has earmarked the Clearwater oil play in Alberta as a major growth region and has recently consolidated its position with the acquisition of c.50 sq km of new acreage. A key attraction here is the inexpensive drilling costs, and the pure oil play offering far greater margins than gas (for reference oil currently accounts for c.16% of i3's production but over 35% of current sales). Approximately 20 sq km of Clearwater acreage was acquired through a recent Crown Land Sale, for a total consideration of under US\$300k, and c.30 sq km (net) will be earned through a farm in agreement with a local operator. i3 will acquire a 50% stake in the latter, in return for paying 75% of the costs of two development wells and committing to paying its pro rata share (50%) of a further seven optional wells. The total firm work programme is expected to cost US\$7m, net to i3, and with gross initial production per well of around 150 bopd (75 bopd net), wells pay back in around one year. The first well is expected to spud later this month, providing a steady stream of drilling newsflow over the next 12 months or so.

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Hedging policy initiated: i3's recent update included confirmation of the company's new hedging policy, with contracts acquired covering in excess of 50% of near-term production. Almost 70% of gas production has been hedged through to 31 October this year at an average price of c.US\$2.3/mcf, bridging the summer months when gas pricing tends to be weaker. Meanwhile a further 750 bpd of oil and 200 bpd of condensate, equating to roughly a quarter of total liquids production, has been hedged until year-end at an average US\$56.7/bbl and US\$26.4/bbl respectively. Going forwards, i3 plans to hedge 50% of oil volumes, and 50-70% of gas volumes in order to protect the dividend and maintenance capex.

Figure 2: Hedge contracts in place

COMMODITY	PERIOD	BOEPD/MMSCFD	AVERAGE PRICE	TOTAL VALUE*	
Crude	1/4/2021	31/12/2021	200	C\$73.70	US\$3.31m
Crude	1/4/2021	31/12/2021	200	C\$75.20	US\$3.38m
Crude	1/3/2021	31/12/2021	350	C\$64.50	US\$5.65m
Propane	1/4/2021	31/12/2021	200	C\$32.45	US\$1.46m
Natural gas	1/6/2021	31/10/2021	21.4	C\$2.83/mcf	US\$7.55m
			Total		US\$21.34m

Sources: i3 Energy. *Assumes CAD:USD rate of 0.82.

Dividend update: In March, i3 announced that it had allocated C\$2m (c.£1.16m, or c.0.16p/shr) in relation to its maiden dividend payout. The company had committed to announcing a special dividend in Q1, before moving to a regular biannual policy, to be announced with the interim results in September. This regular dividend will be set at up to 30% of free cash flow, implying a payout of up to c.US\$3.3m (0.34p/shr) with respect to H1 operations (paid in H2), and implying a 7.7% running yield going forwards.

Payment of the initial dividend has been delayed somewhat due to the requirement of balance sheet restructuring to create distributable reserves. This administrative process requires formal judicial and shareholder approval, and a court date and EGM are expected to be announced imminently, in time for payment most likely early next month. The dividend in relation to H1 2021 activities will be announced and paid in H2.

Financial forecasts and valuation: Based on an average Brent oil price of US\$60/bbl and Henry Hub gas price of US\$2.75/mcf, we forecast 2021 EBITDA of US\$22.4m, pricing the company on an EV/EBITDA multiple of just under 5x. In line with the company's stipulated policy of 30% of free cash flow to be returned to shareholders, we expect c.US\$3.3m to be paid out in relation to H1 2021, equivalent to c.0.34p/shr and placing the company on a healthy running yield of 7.7%. On DCF, we value i3 at a Core (2P) NAV of 16.4p/shr (NPV10), at which we set our target price.

Inorganic growth opportunities: With the two acquisitions successfully bedded-in, i3 is now actively scoping fresh opportunities for growth alongside its organic growth strategy in the Clearwater play. We estimate that the company started the year with around US\$8.5m of cash, and forecast a further c.US\$9m of FY21 free cash flow (net of dividends) which can be used for acquisitions. With net debt/EBITDA at a forecasted 1.1x (FYE21), there is also the potential to use debt finance for new transactions, providing options other than just new equity to finance larger deals. Any transaction priced below 5x EBITDA will be incrementally accretive to cash flow and dividend yield per share (assuming like-for-like funding structure), illustrating the growth potential through M&A.

We initiate coverage on i3 with a DCF-derived (2P NAV, NPV10) target price of 16p/shr. Note that this does not include any value for the Serenity discovery in the North Sea, worth an additional 5p/shr risked on our numbers. Our target price currently offers some 93% upside, with additional upgrades likely in the event of success with the ongoing farm out process on Serenity, and further M&A activity in Canada. Accordingly, we carry a BUY recommendation.

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Figure 3: Valuation summary table

NET ASSET VALUE									
Asset	Gross		Net		Unrisked		CoS	Risked	
	mboe	Interest	mboe	US\$/boe	US\$m	p/shr		US\$m	p/shr
Canada 2PDP reserves	n/a	n/a	26.0	3.0	77	6.6	100%	77	6.6
Deduct: net debt*					(24)	(2.0)		(24)	(2.0)
Add: corporate items					3	0.2		3	0.2
Base NAV			26.0		56	4.8		56	4.8
Canada 2P reserves	n/a	n/a	32.5	5.6	181	15.5	75%	136	11.6
Core (2P) NAV			58.5		237	20.3		192	16.4
Serenity	17.5	100%	17.5	10.71	187	16.0	30%	56	4.8
Total NAV			76.0		424	36.3		248	21.2

Valuation assumptions:

Brent price: US\$60/bbl 2021, flat thereafter.

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

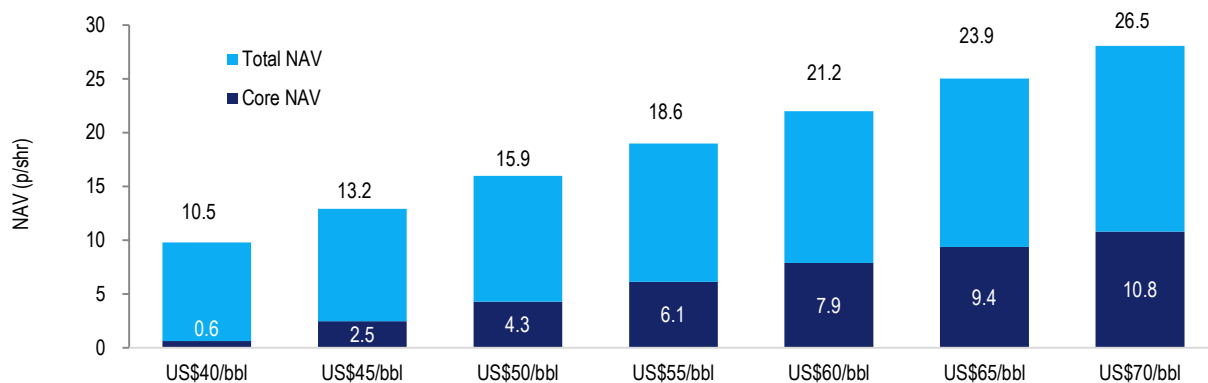
Henry Hub gas price: US\$2.75/mcf 2021, US\$2.60/mcf 2022, US\$2.5/mcf 2023, US\$3/mcf flat thereafter.

Discount rate 10%.

1.39 US dollar / sterling.

722.4m ordinary shares outstanding. 118.6m 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.

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Figure 4: Financial summary – P&L, cash flow and balance sheet

FYE 31ST DEC		2020E	2021E	2022E	2023E	2024E
Net oil & gas production	boepd	2,998	8,980	8,382	7,919	7,502
Average realised price	US\$/boe	19.0	23.1	23.2	24.4	27.5
Net gas volumes	mmscf/d	9.8	34.9	29.8	26.9	24.2
Gas revenue	US\$m	8.6	30.0	24.0	20.6	22.9
Net NGL volumes	bpd	843	2,055	1,849	1,664	1,498
NGL revenue	US\$m	4.8	16.9	15.1	13.6	12.2
Net oil volumes	bopd	517	1,400	1,560	1,779	1,976
Oil revenue	US\$m	7.1	27.6	30.7	35.1	38.9
Revenue	US\$m	20.8	75.9	71.1	70.4	75.3
Operating costs	US\$m	(15.4)	(44.9)	(42.0)	(39.9)	(38.5)
<i>Unit</i>	<i>US\$/boe</i>	<i>(14.0)</i>	<i>(13.7)</i>	<i>(13.7)</i>	<i>(13.8)</i>	<i>(14.1)</i>
G&A costs	US\$m	(8.5)	(8.5)	(8.5)	(8.5)	(8.5)
<i>Unit</i>	<i>US\$/boe</i>	<i>(7.8)</i>	<i>(2.6)</i>	<i>(2.8)</i>	<i>(2.9)</i>	<i>(3.1)</i>
EBITDA	US\$m	(3.1)	22.4	20.6	22.0	28.2
<i>EBITDA margin</i>	<i>US\$/boe</i>	<i>(14.7%)</i>	<i>29.6%</i>	<i>29.0%</i>	<i>31.2%</i>	<i>37.5%</i>
DD&A	US\$m	(4.4)	(11.5)	(10.7)	(10.1)	(9.6)
Finance and other expenses	US\$m	(4.3)	(6.4)	(6.9)	(7.3)	(7.9)
Profit before tax	US\$m	(11.8)	4.5	3.0	4.6	10.8
Income tax	US\$m	-	-	-	-	-
Net income	US\$m	(11.8)	4.5	3.0	4.6	10.8
Adjusted EPS (fully diluted)	c/shr	(1.4)	0.5	0.4	0.5	1.3
Profit before tax	US\$m	(11.8)	4.5	3.0	4.6	10.8
Cash flow reconciliation	US\$m	8.7	17.9	17.6	17.5	17.5
Working capital movements	US\$m	(21.5)	-	-	-	-
Interest paid, net	US\$m	-	-	-	-	-
Tax paid	US\$m	-	-	-	-	-
Net operating cash flow	US\$m	(24.5)	22.4	20.6	22.0	28.2
<i>Cash flow margin</i>	<i>US\$/boe</i>	<i>(22.4)</i>	<i>6.8</i>	<i>6.7</i>	<i>7.6</i>	<i>10.3</i>
Capex (including A&D)	US\$m	(2.1)	(8.6)	(10.4)	(10.4)	(10.4)
Free cash flow	US\$m	(26.6)	13.8	10.2	11.6	17.9
Dividend pay-out	US\$m	-	(4.9)	(6.5)	(6.4)	(7.5)
Acquisitions/divestments	US\$m	(26.3)	-	-	-	-
Debt movement, other	US\$m	-	-	-	-	-
Share issuance	US\$m	36.1	-	-	-	-
Net increase (decrease) in cash	US\$m	(16.8)	8.9	3.8	5.3	10.3
Cash	US\$m	8.2	17.1	20.9	26.1	36.5
Other current assets		0.4	0.4	0.4	0.4	0.4
O&G assets		101.5	97.2	94.7	92.9	91.5
Total assets	US\$m	110.2	114.7	116.0	119.4	128.4
Debt	US\$m	32.0	35.9	40.3	45.1	50.5
Other liabilities & decommissioning	US\$m	27.3	28.3	28.7	29.1	29.5
Shareholder equity	US\$m	65.8	65.4	61.9	60.1	63.3
Total equity & liabilities	US\$m	125.1	129.6	130.9	134.3	143.3
<i>P/E - adjusted, fd</i>	<i>x</i>	<i>(7.1x)</i>	<i>18.4x</i>	<i>27.6x</i>	<i>18.3x</i>	<i>7.7x</i>
<i>EV/EBITDAX</i>	<i>x</i>	<i>(24.6x)</i>	<i>4.8x</i>	<i>5.0x</i>	<i>4.7x</i>	<i>3.6x</i>
<i>Dividend paid</i>	<i>c/shr</i>	<i>-</i>	<i>0.68</i>	<i>0.89</i>	<i>0.88</i>	<i>1.04</i>
<i>Dividend yield</i>	<i>%</i>	<i>-</i>	<i>5.9%</i>	<i>7.7%</i>	<i>7.7%</i>	<i>9.0%</i>
<i>Dividend cover</i>	<i>x</i>	<i>-</i>	<i>2.8x</i>	<i>1.6x</i>	<i>1.8x</i>	<i>2.4x</i>
<i>FCF yield</i>	<i>%</i>	<i>(31.9%)</i>	<i>16.6%</i>	<i>12.3%</i>	<i>14.0%</i>	<i>21.4%</i>

Source: Tennyson Securities.

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Date	Market Index level	Share Price (p)	Target Price (p)	Opinion
13 May 2021	1359.6	8.3	16.0	BUY

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