

28 April 2021

OIL & GAS



Interim Results

Marketing Communication (Connected Research)

Egdon Resources[#]

BBG Ticker: EDR LN

Price: 1.65p

Mkt Cap: £6.62m

BUY

Year to July	Revenue (£m)	EBITDA (£m)	PBT (£m)	EPS (p)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)
2019A	2.20	(1.11)	(1.72)	(0.64)	3.0	n/m	(3.49)
2020A	0.96	(4.53)	(4.75)	(1.45)	6.8	n/m	(1.26)
2021F	1.40	(1.18)	(1.64)	(0.50)	4.7	n/m	(3.66)
2022F	2.19	(0.66)	(1.16)	(0.35)	3.0	n/m	(5.15)

SOURCE: Company data, VSA Capital Research.

FY 2021 Interim Results

Egdon Resources (EDR LN)[#] has reported interim results for the period ended 31st January 2021. Production of 92boepd was within guidance of 90-100boepd leading to revenue of £0.424m. Net cash used in operations was just £1k for the period and net cash at 31st January 2021 was £440k.

Production Update

The anticipated decline at Ceres was behind the reduced output, however, the ramp up to 150boepd of net production from the Wressle oil field comes at an ideal time to support the company's earnings outlook while it pursues high impact development opportunities such as Endeavour and Resolution where seismic is expected to be shot in H1 2022.

Milestones for FY 2021

At Wressle the final ramp up is imminent, with the company awaiting the receipt of environmental consents to allow a proppant squeeze and final ramp up. We expect this to add production in the second half of Financial Year 2021, to achieve overall FY 2021 production of 129boepd; implying 165boepd in H2.

Egdon expects to drill the sidetrack well at Biscathorpe in 2021/2022 and submitted a planning application where a decision is pending. This will target the Dinantian Carbonate, where a 68 m oil column was discovered with gross Mean Prospective Resources of 2.55mbo, with a potential NPV of £55m.

One new area of note is that a memorandum of understanding has been executed with Creative Geothermal Solutions to progress geothermal projects within Egdon's existing portfolio. This could realise value at the end of asset lives within the company's portfolio whilst providing exposure to the energy transition.

Recommendation and Target Price

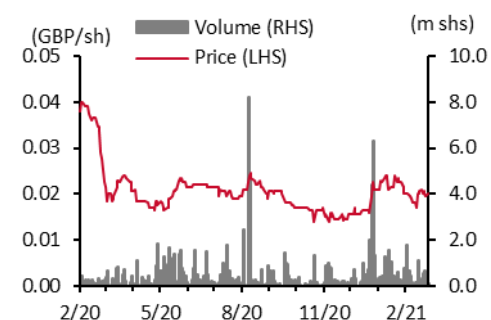
With both prices and production now moving higher, H2 FY 2021 is set to be a stronger period while a pipeline of milestones offers potential future catalysts for the share price.

We reiterate our Buy recommendation target price of 22.5p/sh.

Company Description

Egdon Resources is an oil and gas E&P company with licences in conventional and unconventional basins in the UK.

One Year Price Performance



Price % chg	1mn	3mn	12mn
	-10.8%	1.5%	-28.3%
12mn high/low:			4.0p/1.4p

SOURCE: Eikon, as of 27/04/21 close

Market:	LSE AIM
Price target:	22.5p
Shares in issue (diluted):	401.55m (513.2m)
Free float:	50%
Net cash (31/01/21):	£0.44m
Enterprise value:	£6.18m

Major shareholders

HEYCO Energy Group	33.99%
Encore Oil (Premier Oil)	14.11%
Cannacord Genuity	9.28%

Oliver O'Donnell, CFA, Natural Resources

+44 (0)20 3617 5180 | oodonnell@vsacapital.com

Taro Kiley, Energy Analyst

+44 (0)20 7096 9581 | tkiley@vsacapital.com

#VSA Capital acts as Joint Broker to Egdon Resources.

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Half Year Results

Revenue of £424k was down 37% YoY as a result of declining production and weaker prices, although 1H21 production of 92 boepd, from Ceres, Keddington and Fiskerton Airfield, with Wressle contributing from towards the end of January 2021, was within the 90-100 boepd guidance. Net cash used in operations was just £1k. Production guidance for the full financial year 2020-21 is now 110-130 boepd with the timing of the proppant squeeze treatment at Wressle something which may impact this. We are expecting 2H 2021 production of 165 boepd, making FY 2021 average production of 129 boepd.

Production costs for the half year were 36% lower YoY at £473k and overall cost of sales decreased more than threefold to £998k driven by the absence of an impairment charge. SG&A was lower by 19% YoY at £469k as the cost control measures including temporary salary reductions kicked in. Finance costs remained modest at £97k taking the overall loss to £1.0m or 0.32p/sh. Net cash at 31st January 2021 was £440k following the convertible loan notes (£1.05m) and the loan from Union Jack Oil (£1m) both agreed shortly before the end of the period.

Net capital expenditure in 1H 2021 was £352k, similar to 1H 2020 (£471k) with spending focused on Wressle but otherwise kept to a minimum. The deferral of Resolution means that FY 2021 capex will likely be lower than our previous estimate of £1.2m at £0.9m. This spending will still cover some minor costs at Resolution as well as the start up at Wressle; approval of the proppant squeeze will result in some additional expenditure.

EDR Highlights, £'000

	2018A	2019A	2020A	2021F	2022F
Production, boepd	84	182	145	129	199
Revenue	1,215	2,197	964	1,396	2,185
COGS	(2,190)	(2,876)	(4,695)	(2,019)	(2,323)
SGA	(1,093)	(1,066)	(956)	(908)	(936)
Operating Profit (Loss)	(2,069)	(1,746)	(4,688)	(1,532)	(1,073)
Other	91	29	(60)	(109)	(91)
Net Income	(1,978)	(1,717)	(4,748)	(1,641)	(1,165)
Capex	(1,679)	(2,216)	(869)	(900)	(1,300)

SOURCE: Company data, VSA Capital Research.

Based on our FY2021 Brent oil price of US\$55/bbl, we anticipate revenue of £1.4m in FY 2021. This is marginally higher than our prior FY 2021 forecast of US\$51/bbl and results from a lower realised average price in H1 offset by a more rapid recovery in prices meaning that H2 prices will be stronger than previously anticipated. This combined with the slower ramp up at Wressle means our figures are broadly unchanged.

Wressle; Getting Up and Running

At the Wressle oil field development, oil flows started at the end of January following installation of surface facilities and the recompletion and reperforation of the Ashover Grit reservoir. The well is currently undergoing an Extended Well Test ahead of the planned proppant squeeze and clean-up with produced oil exported to the Phillips 66 Humber refinery. The company is anticipating imminent receipt of Environmental consents for the next stage of operations. When on full production, Wressle-1 is projected to add a net 150bopd to Egdon's production making it an important revenue generator for the company and the main driver for the company to meet production guidance.

We value Wressle at £4.8m (US\$6.1m). Given the expected decline in output from Ceres in the short to medium term, Wressle is coming online at a crucial time adding substantial revenue in FY 2021 and resulting in a net increase in output despite only coming on halfway through the financial year.

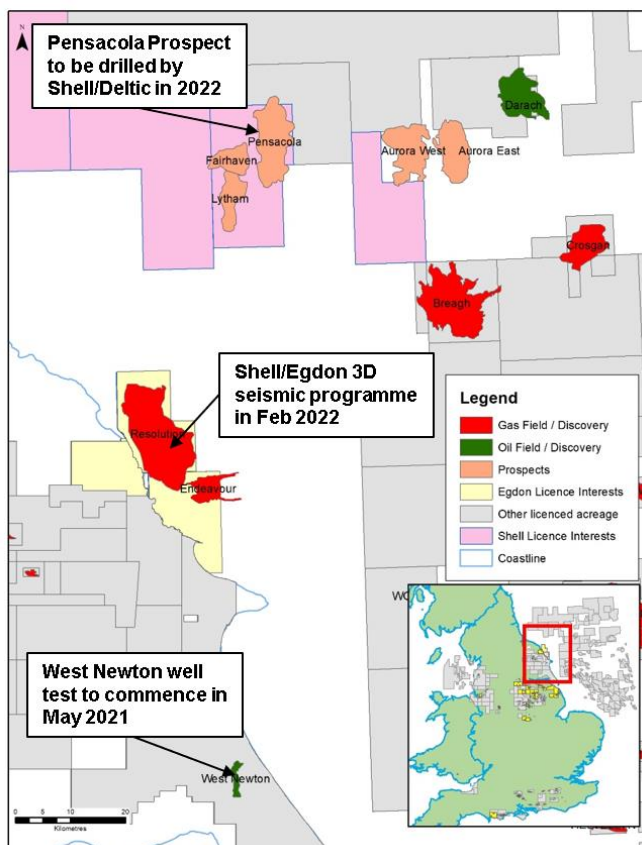
Resolution Update

The P1929 and P2304 licences, which contain Resolution and Endeavour, are one of EDR's most significant assets and Shell's farm in last year follows Shell's £300m investment into the Bacton Gas Terminal to increase capacity by 16% to 400mmcfpd. Additionally, Shell farmed into the Pensacola Prospect, which contains gross P50 Prospective Resources of 309 bcf in the highly prospective Zechstein reef play, the same play as Egdon's Resolution and Endeavour in the UK Southern North Sea. Significantly, Shell has recently made a positive well investment decision and the operator expects to drill the well in 2022. Furthermore, re-interpretation of the new 3D seismic data acquired over Pensacola increased the geological CoS from 20% to 55%.

Having a partner such as Shell able to weather the disruption associated with COVID-19 and continue progressing this regional development is of huge benefit to EDR as it looks to advance and realise value from the Resolution/Endeavour prospects. The fact that these assets are part of a wider strategy for Shell is highly positive, in our view, it demonstrates that this is a wider long-term plan into which Shell is committing time and resources.

The seismic survey is planned for February 2022; this was delayed on the back of results of surveys for wildlife, fishing and tourism which showed that February would be a better time than April due to migratory patterns of certain local species. With the window having passed when the decision was made (delayed by COVID-19) the company was forced to delay until 2022, however, this should mean that the process and remaining approvals are unlikely to cause further issues.

Activity Increasing in the Southern North Sea



SOURCE: Company data, VSA Capital Research.

Biscathorpe

In February 2021 Egdon announced an application for side-track drilling for testing and long term oil production. It follows the Biscathorpe 2 well which intercepted a 68 m oil column with gross Mean Prospective Resources of 2.55

mmbo, overlain by the Basal Westphalian Sandstone, where gross Mean Prospective Resources of 3.95mmbo were estimated by the company.

Assuming a successful application decision Egdon expects to drill the side-track well in 2021-22. A joint farm-out process is currently ongoing; EDR currently hold a 35.8% interest. It is worth highlighting that the Lincolnshire Council to which the application was submitted is a distinct entity from the North Lincolnshire Council to which the Wressle application was made.

North Kelsey

The North Kelsey Prospect (PEDL241: Egdon 50%) has Mean Prospective Resources of 6.47 mmbo. Planning consent has been extended to 31 December 2021 and Egdon and Union Jack Oil completed the alignment of equity on a 50:50 basis. A joint farm-out process is currently underway.

Energy Transition Opportunities

On 23 April 2021, a memorandum of understanding was executed with Creative Geothermal Solutions (CGS), a team of highly experienced engineers and service providers, to explore the possibilities for geothermal repurposing of some of Egdon's existing assets and to look at wider opportunities.

Egdon's initial review of the geothermal potential within its existing wells and fields highlighted an anomalously high geothermal gradient in the area of its shut-in wells at the Dukes Wood and Kirklington oil fields making these wells initial potential candidates for repurposing for geothermal heat production. During the period Egdon extended the planning consent to retain the existing Kirklington site whilst detailed feasibility studies including understanding of the regulatory aspects are completed, and the regulatory aspects are further explored.

Valuation

We use a sum-of-the-parts methodology to value both EDR's conventional and unconventional assets.

NAV Calculation

Licence	Prospects	Timing	Type	Unrisked (mboe)	Equity (%)	CoS	Net risked (mboe)	Net risked/sh
PEDL 005	Keddington	Producing	Oil	0.2	45%	100%	0.1	0.4
P1241	Ceres (block 47/9C)	Producing	Gas	2.0	10%	100%	0.2	1.2
PEDL 070	Avington	Producing	Oil	0.3	27%	100%	0.1	0.4
EXL294	Fiskerton Airfield	Producing	Oil	0.1	80%	100%	0.1	0.4
Producing				2.6			0.4	2.4
PEDL 180	Wressle	H2 19	Oil	1.5	30%	100%	0.5	1.0
Development				1.5			0.5	1.0
Financing								0.0
P1929	Resolution	H1 20	Gas	38.4	30%	55%	6.3	7.3
P2304	Endeavour	H1 20	Gas	4.5	30%	55%	0.7	0.9
Contingent				60.7			7.1	8.2
PEDL 241	North Kelsey	H1 18	Oil	6.7	50%	40%	1.3	2.3
PEDL 253	Biscathorpe	H1 18	Oil	7.3	36%	40%	1.0	1.8
Exploration				26.3			3.7	4.1
UK Shale								6.8
TOTAL NAV								22.5

SOURCE: Company data, VSA Research.

With Wressle in ramp up mode we expect this to start to contribute to the company's earnings and continue to believe that the successful ramp up will feed through to a higher share price. Further progress at Biscathorpe and subsequently at Resolution/Endeavour provides additional catalysts, while a successful well at Pensacola may provide a positive read through for EDR. In each case, our risked valuations demonstrate significant upside potential which is currently not reflected. Farm ins at Biscathorpe and North Kelsey present further possible milestones.

We continue to value the shale assets within EDR's portfolio as the company intends to keep the licenses in good standing until such a time as they can continue to derisk them. As yet, we do not include any value for the potential from the company's initiatives in relation to transitional energy and in particular the geothermal potential at Kirklington. As the company states, the UK's future energy mix is likely to be a balance of fossil fuels and renewable energy and using the management's intimate knowledge of the UK's onshore energy potential both from a geological and an infrastructure perspective to support the energy transition gives the company an advantage, in our view.

Estimated Value of the UK Shale Assets

Net Acres	CoS %	US\$/acre	EMV (\$m)	Net risked/ share
189,000	30%	787	45	6.8

SOURCE: Company data, VSA Capital Research.

We reiterate our BUY recommendation and target price of 22.5p/sh.

Financials

Assumptions and Volumes

	2019	2020	2021F	2022F
Macro Assumptions				
Brent Oil Price Average (US\$/bbl)	68.3	53.6	55	60
Volumes (Year End July)				
Working interest production rate (kboe/d)	0.18	0.15	0.13	0.2

SOURCE Company data. VSA Capital Research.

Profit & Loss £'000

	2019	2020	2021F	2022F
Revenue	2,197	964	1,396	2,185
Cost of Sales - Exploration Costs Written off and Pre-License Costs	(46)	(194)	-	-
Cost of Sales - Impairments and Impairment Reversals	-	(2,835)	-	-
Cost of Sales - Other	(2,244)	(1,697)	(1,312)	(1,908)
Cost of Sales - Depreciation	(632)	(163)	(353)	(415)
Total Cost of Sales	(2,876)	(4,695)	(2,019)	(2,323)
Gross Profit	(680)	(3,731)	(623)	(138)
Administrative Expenses	(1,066)	(956)	(908)	(936)
Other Operating Income	78	61	-	-
Finance Income	4	48	-	-
Finance Costs	(53)	(170)	(109)	(91)
Loss for the Period	(1,717)	(4,748)	(1,641)	(1,165)

SOURCE: Company data. VSA Capital Research.

Cash Flow £'000

	2019	2020	2021F	2022F
Loss Before Tax	(1,717)	(4,748)	(1,641)	(1,165)
Adjustments for:				
Depreciation and Impairment of Fixed Assets	1,040	3,017	353	415
Exploration Costs Written Off / (Written Back)	-	-	-	-
Re-instatement provision written-off	(97)	(3)	-	-
Foreign Exchange Gains	4	13	-	-
Revaluation of Accrued Income	-	-	-	-
Decrease in Trade and Other Receivables	(435)	(103)	300	600
(Decrease)/Increase in Trade and Other Payables	229	1,492	500	500
Increase in Inventory	8	(5)	-	-
Finance Costs	53	170	-	-
Finance Income	(4)	(48)	-	-
Share Based Remuneration Charge	11	9	-	-
Cash Flow (Used in)/Generated from Operations	(907)	(207)	(488)	350
Finance Costs - Facility Fee	-	-	-	-
Net Cash (used in)/Generated From Operating Activities	(907)	(207)	(488)	350
Investing Activities				
Financial Income	4	1	-	-
Purchase of Exploration and Evaluation Assets	(2,096)	(842)	-	-
Purchase of Property, Plant & Equipment	(124)	(59)	(900)	(1,300)
Sale of Property Plant & Equipment		31		
Net Cash Flow Used for Investing	(2,216)	(869)	(900)	(1,300)
Financing Activities				
Net Issue of Shares	1,974	500	-	2,500
Net Changes in Borrowings		(157)	2,000	(2,000)
Costs Associated With Issue of Shares	-	(25)	(130)	-
Net Cash Flow Generated from Financing	1,974	318	1,870	500
Net Increase/(Decrease) in Cash and Cash Equivalents	(1,150)	(758)	482	(450)
Cash and Cash Equivalents at the Start of the Period	2,749	1,618	847	1,329
Effects of Exchange Rate Changes on the Balance of Cash	-	(13)	-	-
Cash and Cash Equivalents at the End of the Period	1,599	847	1,329	880

SOURCE: Company data. VSA Capital Research.

Balance Sheet £'000

	2019	2020	2021F	2022F
Non-Current Assets				
Intangible Assets	21,781	21,451	21,451	21,451
Property, Plant & Equipment	9,696	9,099	7,845	6,130
Total Non-Current Assets	31,477	30,550	29,297	27,582
Current Assets				
Trade and Other Receivables	1,675	1,832	2,132	2,732
Inventory	-	5	0	0
Available for Sale Financial Assets	-	-	-	-
Cash and Cash Equivalents	1,618	847	1,342	905
Total Current Assets	3,293	2,685	3,474	3,637
Total Assets	34,770	33,235	32,771	31,219
Current Liabilities				
Trade and Other Payables	1,379	3,019	3,519	4,019
Borrowings	-	-	1,920	-
Total Current Liabilities	1,379	3,019	5,439	4,019
Non-Current Liabilities				
Provisions	2,397	3,545	3,545	3,545
Total Liabilities	3,775	6,565	8,985	7,565
Equity				
Share Capital	14,984	15,234	15,234	18,609
Share Premium	26,743	26,968	26,968	26,968
Share Based Payment Reserve	114	122	122	122
Retained Deficit	(10,846)	(15,654)	(19,138)	(22,045)
Total Equity	30,994	26,670	23,186	23,654
Total Equity and Liabilities	34,770	33,235	32,171	31,219

SOURCE: Company data. VSA Capital Research.

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- BUY: The stock is expected to increase by in excess of 10% in absolute terms over the next twelve months.
- HOLD: The price of the stock is expected to move in a range between -10% and +10% in absolute terms over the next twelve months.
- SELL: The stock is expected to decrease by in excess of 10% in absolute terms over the next twelve months.

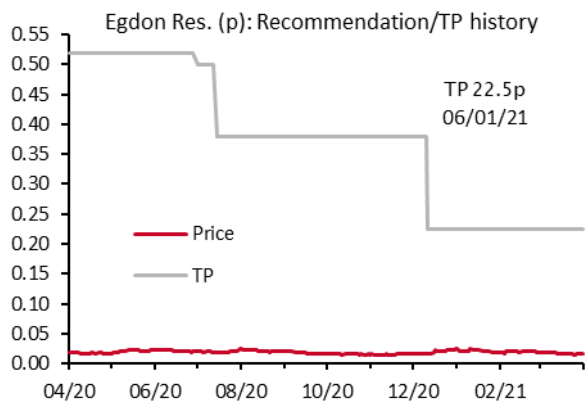
In addition, on occasion, if the stock has the potential to increase by in excess of 10%, but on qualitative grounds rather than quantitative, a SPECULATIVE BUY may be used.

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Equities breakdown: 31 December 2016	Spec. BUY	BUY	HOLD	SELL
Overall equities coverage	25%	75%	0%	0%
Companies to which VSA has supplied investment banking services	25%	75%	0%	0%

Recommendation and Target Price History



SOURCE: FactSet data, VSA Capital Research.

Valuation basis

We value Egdon's conventional assets using a sum-of-the-parts methodology. We then take into account its unconventional shale gas acreage, which is valued at cUS\$787/acre in light of the most recent deals.

Risks to that valuation

Risks to our valuation include possible disappointing drilling results delays to farm-outs and oil price uncertainty.

This recommendation was first published on 13 November 2017.