

Cap Energy

Company update

Oil discovered offshore Senegal

Oil & gas

21 October 2014

Price **145.00p**
Market cap **£42m**

US\$1.6/£

Net cash (£m) at 30 June 2014 0.01

Shares in issue 29m

Free float 12.2%

Code CAPP

Primary exchange ISDX

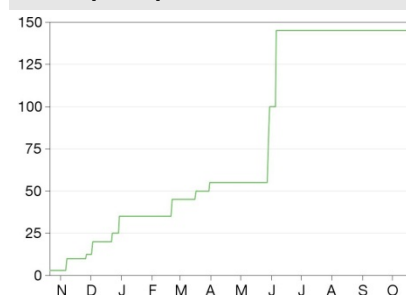
Secondary exchange N/A

The discovery of oil in Cairn Energy's FAN-1 well offshore Senegal has confirmed a proven hydrocarbon system in the basin and should boost the prospectivity of Cap Energy's assets in the adjacent Djiffere block. However, the second well in Cairn's campaign, the SNE-1 well currently drilling, will be more geologically analogous to Cap's future prospects in Senegal. In saying this, the FAN-1 well is relevant to the company's other key area of Guinea-Bissau, where a 3D seismic survey is planned to kick off in early November 2014 and will be used together with the application of Rex Virtual Drilling technology to identify oil-bearing prospects.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	Debt (£m)	Net cash/ (debt) (£m)	Capex (£m)
12/12	0.0	(0.1)	(0.1)	0.0	0.0	(0.2)
12/13	0.0	(0.6)	(0.6)	0.0	0.9	(0.6)
12/14e	0.0	(1.0)	(1.0)	(0.8)	(0.5)	(1.9)
12/15e	0.0	(1.2)	(1.3)	(7.3)	(7.3)	(5.3)

Note: *PBT is normalised, excluding intangible amortisation, exceptional items and share-based payments.

Share price performance



%	1m	3m	12m
Abs	0.0	0.0	4733.3
Rel (local)	8.8	7.3	4995.9
52-week high/low	145.00p	3.00p	

Business description

Cap Energy is an independent upstream oil and gas company focused on the exploration, production and development of conventional hydrocarbons in sub-Saharan Africa.

Next events

Senegal 2D analysis	Q414
SNE-1 drilling	Q414
G-B 3D survey	Start November 2014
G-B 3D analysis	Q115

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Spotlight on Senegal

Cairn's success in Senegal is likely to focus investor's attention on the region, having confirmed a working petroleum system and de-risking at least source and migration across a range of basin plays. However it is the outcome of its next well, SNE-1 that will be most relevant for Cap Energy. Sitting on the shelf edge, SNE-1 is more geologically analogous to Cap's prospectivity in the Djiffere block. Having acquired its Senegalese assets in February 2014, the company has moved quickly to progress its portfolio, completing a 3700km 2D seismic survey in June 2014 and planning to complete the interpretation and Virtual Drilling analysis by the end of November with a view to having a 3D survey carried out in Q115 and to complete the identification of the most suitable prospect to drill by the end of Q315.

Impact on Guinea-Bissau

In addition to Senegal, with the deepwater geology of Cap's Block 5B in Guinea-Bissau analogous to that encountered in FAN-1, there should also be a positive read-across for this frontier area. The upcoming 3D survey planned for the block will allow a more thorough comparison and potential further de-risking. 20 leads have been identified in Block 5B based on 2D seismic and are being refined, together with a Virtual Drilling analysis for input into the design of the 3D survey. Meanwhile the 2013 2D seismic data acquired across Block 1 are being reinterpreted and a Virtual Drilling analysis will be carried out here during H214.

Financials: Funding required for 3D seismic

Cap remains at too early a stage to assign a RENAV valuation. The current focus is on securing c £7m of additional finance, primarily to cover 3D seismic in Guinea Bissau. Cap management has received assurances of funding being available from its major shareholders, while a farm-out also remains a possibility. Funding may also come from a raise linked to a move to AIM, most likely now in 2015.

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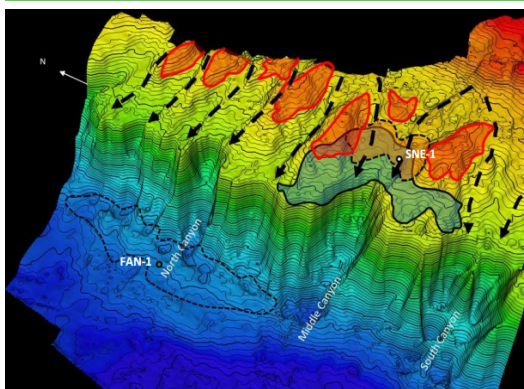
FAN-1 discovery highlights Senegal potential

Cairn Energy has announced the discovery of oil in its FAN-1 exploration well, around 100km offshore the coast of Senegal and to the west of Cap's Djiffere block. The well encountered 29m of net oil-bearing reservoir in Cretaceous sandstones (mainly in the H300 North Fan) with oil ranging between 28° API and 41° API. Cairn estimates that the structure contains gross P50 STOIIIP of 950mmbbls, albeit with a large range of uncertainty with a P90 to P10 STOIIIP range of 250mmbbls to 2,500mmbbls. No testing of the well has been carried out so we do not have any indication of recoverable resources, although these are likely to be lower than previous operator gross mean prospective resource estimates of 282mmbbls and 535mmbbls for the H150 and H300 fans respectively. Cairn has indicated that a discovery greater than 250mmbbls recoverable is likely to be commercial.

As a deepwater fan prospect FAN-1 is not directly analogous to the shallower shelf prospects likely to be targeted by Cap. However, a successful discovery in the Sangomar block adjacent to Cap's acreage is positive news for the area. It confirms the presence of a working petroleum system that had been suspected based on oil shows from four wells drilled in a neighbouring block by Esso between 1968 and 1972. Cap management also believes that this will de-risk the source, migration and presence of kitchen in Djiffere.

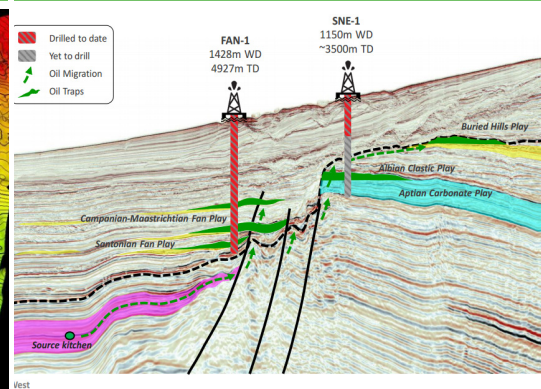
Once operations on FAN-1 are completed, Cairn will move the Cajun Express semi-sub closer to the coastline to drill its second and final well in this campaign. SNE-1 is targeting 550mmbbls of gross mean unrisks prospective resources across two objective reservoirs, the Albian Clastic and Aptian Carbonate. The well is a shelf-edge prospect that is more closely analogous to Cap's Djiffere block prospectivity, all of which is located on the shelf edge. Further success here for Cairn should materially upgrade Cap's potential for success in Djiffere. SNE-1 was estimated to take 45 days to drill; however, since the top hole section is already in place in the well, we expect the drilling time to be reduced if drilling issues are not encountered. The top-hole section was drilled in May 2014 when deeper drilling on FAN-1 had to be halted due to rig maintenance issues. This unscheduled maintenance resulted in a delay to work on FAN-1 of around 47 days.

Exhibit 1: 2014 Sangomar wells



Source: FAR

Exhibit 2: 2014 Sangomar wells on seismic



Source: FAR

Having acquired its 44.1% share of the Djiffere block in February 2014, Cap hopes to drill a well in 2015, and is currently working to identify suitable prospects. The company carried out a 3,700km 2D seismic survey across the block between April and June 2014. Processing these data is ongoing, with interpretation expected to be completed by the end of the year. Results from the FAN-1 well will also be incorporated in the interpretation. Simultaneously, the seismic data will undergo a Virtual Drilling analysis, a technology exclusive to Cap's partner TAOL, which aims to predict the presence of liquid hydrocarbons and thereby significantly de-risk the prospects before drilling.

Beyond the existing awarded acreage, press reports have also indicated that Senegal authorities are aiming to award exploration licences for two more offshore blocks by the end of the year. The same report also indicates that state-run Petrosen is looking to secure funding to pursue a third block on its own.

3D seismic planned for Guinea-Bissau

Although the spotlight is currently on Senegal due to Cairn's ongoing drilling campaign, Cap is also working to progress its interests in neighbouring Guinea-Bissau. Sitting in the same basin as the Senegal assets, the prospective leads are distributed across a carbonate shelf that passes abruptly to deeper water to the west. As the deepwater geology of Cap's Block 5B is analogous to that of the FAN-1 location in Senegal, Cap plans to use the results of Cairn's well to look for similar prospects in its Guinea-Bissau acreage. This will become more accurate when tied into a 3D survey planned to start in November 2014 over Block 5B. The company believes that the presence of source rock in FAN-1 increases confidence that it is also present in Guinea-Bissau.

In addition, seismic survey operator Polarcus has carried out two 3D surveys offshore Guinea-Bissau separate to Cap's blocks, which have identified several fan systems on the shelf edge similar to those in Senegal.

Preparations are being finalised for the Block 5B survey to de-risk the leads identified on 2D seismic. The majority of leads here sit on the shelf, in water depths between 1,125m and 3,150m, although some sit in water depths of 3,200m to 3,500m. The P50 STOIPs are mostly over 100mmbbls, with the largest assessed at 2,433mmbbl.

Block 1 sits in much shallower waters of up to 100m and within easy reach of shore. The mean prospective resources are in the region of 50-120mmbbls. A Virtual Drilling analysis on Block 1 seismic data is underway to identify prospects and is expected to be completed by the end of 2014.

Valuation and financials: Funding is current focus

Cap remains at too early a stage to consider a RENAV valuation, although there is significant upside potential if the company can upgrade its leads to drill-ready prospects. Consistent with our April 2014 [initiation note](#), we estimate a 300mmbbl prospect would add between 11p and 102p per share depending on the acreage and PSC terms. Meanwhile, Guinea-Bissau blue-sky valuations could exceed £20/share, although this is speculative pending further 3D seismic.

Since our initiation note, Cap has continued to be extremely thinly traded, which means that minor dealing activity can have a large impact on the company's share price. Since the beginning of May 2014 there has been only £62k of trading in Cap stock, but this has still increased the share price from 45p to 140p/share.

Funding continues to be tight while the company remains held primarily by directors and related parties. However, we estimate that £7.3m will be required through to end 2015, primarily to fund 3D seismic surveys, initially in Block 5B and then in Block 1, as well as possibly Senegal. This may be funded either through a shareholder loan, equity raise or potentially a farm-out (shown in our models as debt only for illustrative purposes). If funding is through a shareholder loan, we would expect Cap to look to move to an IPO, although this is now likely to be a 2015 event rather than in H214, as was previously planned.

Exhibit 3: Financial summary

	£'000s	2011	2012	2013	2014e	2015e
Dec		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		0	0	0	0	0
Cost of Sales		0	0	0	0	0
Gross Profit		0	0	0	0	0
EBITDA		(61)	(114)	(625)	(993)	(1,202)
Operating Profit (before amort. and except.)		(61)	(114)	(625)	(993)	(1,202)
Intangible Amortisation		0	0	0	0	0
Exceptionals		(0)	25	0	0	0
Other		0	0	0	0	0
Operating Profit		(61)	(90)	(625)	(993)	(1,202)
Net Interest		(41)	49	1	0	(138)
Profit Before Tax (norm)		(102)	(65)	(624)	(993)	(1,340)
Profit Before Tax (FRS 3)		(102)	(41)	(624)	(993)	(1,340)
Tax		0	0	0	0	0
Profit After Tax (norm)		(102)	(65)	(624)	(993)	(1,340)
Profit After Tax (FRS 3)		(102)	(41)	(624)	(993)	(1,340)
Average Number of Shares Outstanding (m)		0.9	2.9	11.4	28.9	29.0
EPS - normalised (p)		(11.6)	(2.2)	(5.5)	(3.4)	(4.6)
EPS - normalised fully diluted (p)		(6.9)	(2.2)	(5.5)	(3.4)	(4.6)
EPS - (IFRS) (p)		(11.6)	(1.4)	(5.5)	(3.4)	(4.6)
Dividend per share (p)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)		N/A	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A	N/A
BALANCE SHEET						
Fixed Assets		269	2	2,527	4,479	9,792
Intangible Assets		0	0	2,508	4,383	7,571
Tangible Assets		269	2	19	14	2,139
Investments		0	0	0	82	82
Current Assets		0	222	913	391	88
Stocks		0	0	0	0	0
Debtors		0	4	32	88	88
Cash		0	0	881	303	0
Other		0	219	0	0	0
Current Liabilities		(156)	(264)	(193)	(1,722)	(910)
Creditors		0	0	(25)	(216)	(216)
Short term borrowings		0	(0)	0	(812)	0
Other current liabilities		(156)	(264)	(168)	(694)	(694)
Long Term Liabilities		(507)	0	0	(0)	(7,161)
Long term borrowings		0	0	0	0	(7,299)
Other long term liabilities		(507)	0	0	(0)	138
Net Assets		(394)	(40)	3,247	3,148	1,808
CASH FLOW						
Operating Cash Flow		(136)	22	(974)	(321)	(1,340)
Net Interest		0	49	1	0	(138)
Tax		0	0	0	0	0
Capex		0	(222)	(585)	(1,881)	(5,313)
Acquisitions/disposals		0	0	0	0	0
Financing		0	150	3,568	902	0
Dividends		0	0	0	0	0
Other		0	(0)	(1,130)	(90)	0
Net Cash Flow		(136)	(0)	880	(1,390)	(6,790)
Opening net debt/(cash)		(8)	(0)	(0)	(881)	509
HP finance leases initiated		0	0	0	0	0
Other		128	(0)	1	0	0
Closing net debt/(cash)		(0)	(0)	(881)	509	7,299

Source: Company accounts, Edison Investment Research

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