Market Update

Marketing Communication (Connected Research)

Independent Oil & Gas#

BBG Ticker: IOG LN *Price: 31.1p* *Mkt Cap: £31.9m* **BUY**

Year to Dec	Revenue (£m)	EBITDA (£m)	PBT (£m)	EPS (p)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)
2014A	0.0	(11.0)	(12.1)	(19.2)	n/m	n/m	n/m
2015A	0.0	5.3	5.3	7.4	n/m	6.6	4.6
2016E	0.0	(1.5)	(1.8)	(1.8)	n/m	n/m	n/m
2017E	0.0	(1.6)	(1.9)	(1.3)	n/m	n/m	n/m

***SOURCE**: Company, VSA Capital estimates.*

Vulcan Satellites Add to the Hub Strategy

On 13 June, **Independent Oil & Gas (IOG)#** signed an SPA with **Verus Petroleum** to acquire its subsidiary **Oyster Petroleum**. The acquisition remains conditional to Verus transferring certain licences into Oyster and will see IOG create an additional hub in the Southern North Sea (SNS) increasing its 2C resources by 320.7BCF (c53mmboe).

No Further Appraisal Required

The licences being acquired by IOG contain the Vulcan East, Vulcan North West and Vulcan South fields, collectively known as the Vulcan Satellites and require no further appraisal. The Vulcan Satellites lie 30-45km east of IOG's Blythe field. IOG is in advanced discussions with regards to an export route for its SNS hubs. Once these are arranged IOG will be able to prepare the Field Development Plan (FDP).

On completion of the transaction IOG's combined 2P reserves and 2C resources will increase to 102.3mmboe. Oyster also has a significant cUS$25.6m of losses which can be carried forward to improve the economics of any producing asset acquisition.

Skipper Appraisal Well Successfully Completed

IOG also recently announced that its Skipper well was drilled to 3,860ft retrieving good quality reservoir condition oil samples allowing it to finalise the Skipper field FDP. Whilst testing of the samples will not complete until September 2016 the early indication is that the samples appear to be within IOG's anticipated range of 50-150cP and better than the CPR's estimate. This indicates that the oil appears to be significantly less viscous than first thought and more mobile within the reservoir.

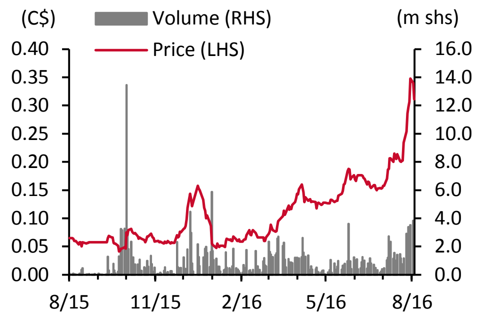
Recommendation and Target Price

We assume that the Oyster transaction will complete successfully in the coming months and therefore **maintain our BUY recommendation but have increased our TP to 124p**. However, this is contingent on the completion of the acquisition and in the case that it should not we will revert back to our core NAV of 74p.

Company Description

E&P company focused on developing O&G assets in the UK North Sea.

One Year Price Performance



Price % chg	1mn	3mn	12mn
	112.7%	177.8%	601.1%
12mn high/low:			4.1p /34.8p

***SOURCE**: FactSet, as of 16/08/16 close.*

Market:	LSE AIM
Price target:	124p
Shares in issue:	102.6m
Free float:	71%
Net debt (16/08/16):	£0m
Enterprise value:	£32.0m
Next news:	Vulcan Completion

Major shareholders	
Hargreaves Lansdown*	30.3%
(*Peter Young)	13.5%
TD Direct Investing Nominees*	10.5%
(*Mark Routh)	4.2%
Acura Oil & Gas	6.8%

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Valuation

We have used a sum-of-the-parts methodology where we include the Blythe and Elgood gas fields and the Skipper heavy oil field into our core NAV. We have now added the Vulcan Satellites to our valuation but for now we consider it separately as the transaction is yet to complete and will have a significant impact on our TP. However, once the deal has completed we will add the fields into our core NAV.

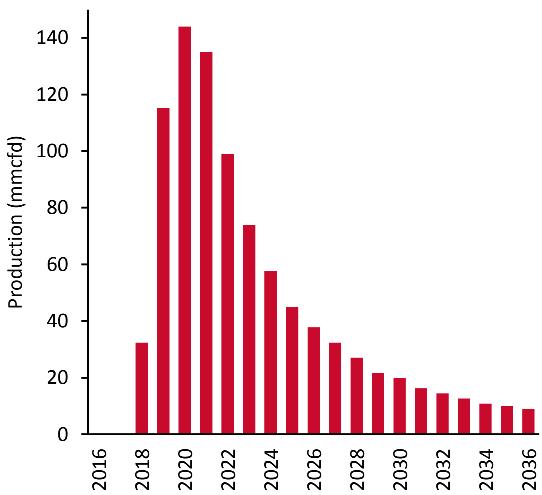
NAV Table

Fields	Timing	Type	Unrisked mmboe	Equity %	CoS %	EMV US$m	Net risked p/sh	Potential Upside p/sh
Blythe	2018	Gas	6.2	100%	50%	20	13	13
Elgood	2018	Gas	2.0	100%	50%	6	4	4
Skipper	2018	Oil	26.2	100%	50%	92	58	58
Core NAV						**118**	**74**	**74**
Vulcan Satellites	2018	Gas	53.5	100%	30%	80	50	117
Contingent NAV						**80**	**50**	**117**
Total NAV						**198**	**124**	**191**

SOURCE: *VSA* Capital estimates.

In June 2016 IOG signed an SPA to acquire the Vulcan Satellites to add three fields to its portfolio and increase its 2C resources by 320.7BCF (53.5mmboe) with in place volumes of >500BCF. Aligned with its strategy this deal will create a new hub in close proximity to the Blythe Field, the location of IOG's other proposed hub in the SNS. IOG also completed the acquisition of the remaining 50% of the Blythe licence in June 2016 to now own 100% and increase its 2P reserves on the field to 34.3BCF (6.2mmboe). The Vulcan Satellites, therefore, has a significantly larger resource base than the Blythe. Under the terms of the Vulcan deal IOG will pay an initial consideration of £1m, £750k nine months after completion with up to an additional £3.25m upon certain milestones being met in the development stage of the Vulcan Satellites. The initial consideration will be funded by drawing down on IOG's available loan facilities.

Vulcan Satellites Production



SOURCE: *Independent Oil & Gas.*

The creation of a second possible hub in the SNS should also bring about significant economies of scale as both hubs are expected to share an export route which should be finalised in the coming months. IOG have provisionally planned for seven wells over the development of the three fields with an estimated peak production of c150mmcfd. The three fields are in relatively shallow water and will be developed using unmanned platforms bringing down costs. Furthermore the downturn in oil prices has created strategic opportunities for exploration and development companies, such as IOG, by allowing them to take advantage of the current contract pricing environment as the service companies tighten their margins. Given that drilling operations often account for the majority of capex on projects these savings could be significant.

Each discovery well on the three fields has a minimum gas column of 230ft that will support a multi-frac horizontal well development. Furthermore analogue field data from Clipper South, Victoria, Kew, K18 Golf and Annabel demonstrate that these discoveries can be economically developed. We use a cautious 30% CoS to take into account for the fact that development funding is not yet secured and to take into account for the geological risk associated with the project. We therefore **maintain our BUY recommendation and have increased our TP to 124p**

Finally the Skipper well will now continue to explore the two prospects in the Lower Dornoch and Maureen formations which together have an estimated STOIIP of 46mmbbl. If successful they have the potential to add significant upside.

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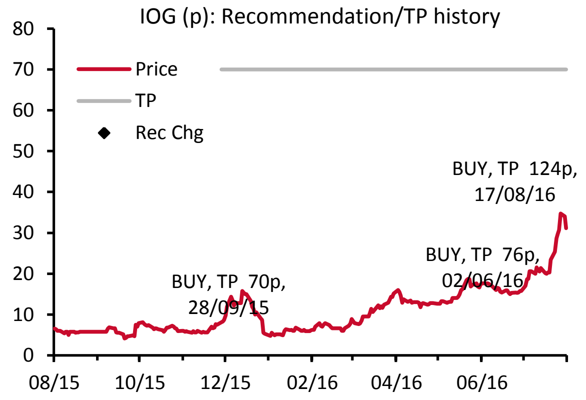
Equities breakdown: 30 June 2015	Spec. BUY	BUY	HOLD	SELL
Overall equities coverage	26.3%	68.4%	5.3%	0.0%
Companies to which VSA has supplied investment banking services	25.0%	75.0%	0.0%	0.0%

Recommendation and Target Price History



***SOURCE**: FactSet data, VSA Capital estimates.*

Valuation basis

We have used a sum-of-the-parts methodology where we include Blythe and Elgood gas fields as well as Skipper heavy oil field into our core NAV since these are expected to be the first developments undertaken by IOG in 2017-18.

Risks to that valuation

The main risks to our valuation is related to commodity price uncertainty and development delays.

This recommendation was first published on 28/09/15.