

Otto Energy Ltd

(OEL \$0.008) Buy, upgrade from Speculative Buy



| Analyst | Date | Price Target |
|------------|--------------------------------|--------------|
| Jon Bishop | 3 rd September 2020 | \$0.03/sh |

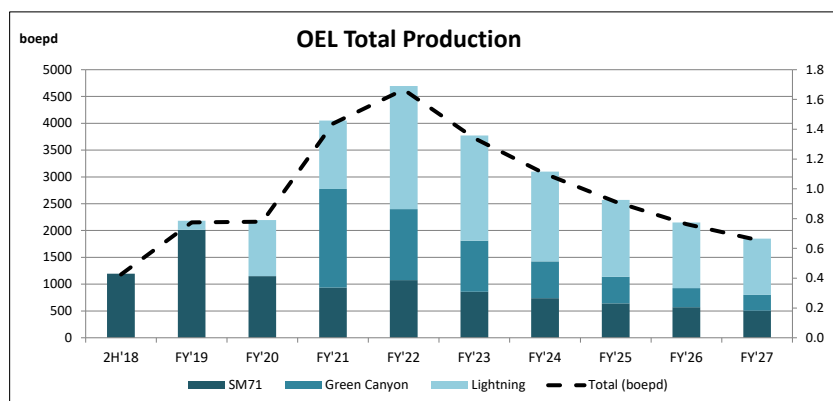
Green Canyon Production Nears: Change to Recommendation

Investment case

The Green Canyon oil development is due to commence production mid Dec H CY'20. OELs net interest provides additional production that results in a near doubling of Group production in FY'21 from FY'20. EBITDA follows increasing 100% to US\$27m; a number largely underwritten by a hedge book that accounts for a majority of FY'21 oil production. Op FCF of US\$28m will be generated and yet remarkably OELs current EV is a mere US\$30m. OEL is fundamentally cheap: With medium term earnings protected and oil prices arguably nearer historical lows we see excellent potential to OEL to re-rate with delivery of Green Canyon in the coming weeks. We upgrade recommendation to BUY as a consequence.

Key points

- The c.10kbbopd offshore Green Canyon development is due to commence production mid Dec H, CY'20;
- As recently guided in the Jun Q'ly, there have been no material delays or changes to pre-production capex estimates;
- The impact to OELs Group production profile is material, with net rates doubling from FY20 (ESL est. ~2,100boepd) to FY'21 (ESL forecast - ~4,000boepd):



- Of greater significance is the impact to earnings:
 - FY'21 - EBITDA of US\$27m vs our forecast US\$14m in FY20; in
 - FY'22 - EBITDA of US\$42m with a FY production from GC and assuming av. price received of US\$56/bbl;

| Otto Energy Ltd | Year End 30 June | |
|-----------------|------------------|--------|
| Share Price | 0.008 | A\$/sh |
| Price Target | 0.03 | A\$/sh |
| Valuation | 0.031 | A\$/sh |

| | | |
|-----------------------|---------------------|-------------------------|
| Shares on issue* | 4842 | m, diluted |
| Market Capitalisation | 39 | A\$m |
| Enterprise Value | 45 | A\$m |
| Debt | -31 | A\$m |
| Cash | 25 | A\$m |
| Largest Shareholder | Molton Holdings Ltd | 48.1% *fully diluted |

| Production F/Cast | 2019a | 2020f | 2021f |
|-------------------------|-------|-------|-------|
| Attrib. Prod'n (mmbboe) | 0.8 | 0.8 | 1.5 |

| Assumptions | 2019a | 2020f | 2021f |
|-------------------------------------|-------|-------|-------|
| Avg LLS Oil Price Rec'd (A\$/bbl)60 | | 43 | 41 |
| AUDUSD | 0.74 | 0.67 | 0.70 |

| Key Financials | 2019a | 2020f | 2021f |
|------------------|-------|-------|-------|
| Revenue (US\$m) | 31 | 24 | 41 |
| EBITDA (US\$m) | 22 | 14 | 29 |
| NPAT (US\$m) | -18 | 0 | 11 |
| Cashflow (US\$m) | 21 | 14 | 28 |

| | | | |
|------------|-----|-----|-----|
| CFPS (Ac) | 1 | 0 | 1 |
| P/CFPS (x) | 4.1 | 1.8 | 1.0 |

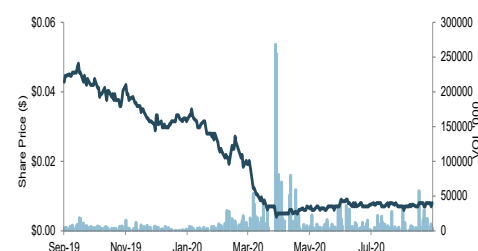
| | | | |
|----------------|----|----|-----|
| EPS (Ac) | -1 | 0 | 0 |
| EPS growth (%) | na | na | na |
| PER (x) | na | na | 2.4 |

| | | | |
|---------------|------|------|-----|
| EV:EBITDA (x) | 2.1 | 3.0 | 1.4 |
| EV:EBIT (x) | -2.4 | 66.3 | 3.3 |

| | | | |
|--------------------|-----|-----|-----|
| DPS (Ac) | 0.0 | 0.0 | 0.0 |
| Dividend Yield (%) | 0% | 0% | 0% |

| | | | |
|------------------------|----|------|------|
| ND:Net Debt+Equity (%) | na | 2% | 1% |
| Interest Cover (x) | na | 16.5 | 56.7 |

Share Price Chart



Disclaimer

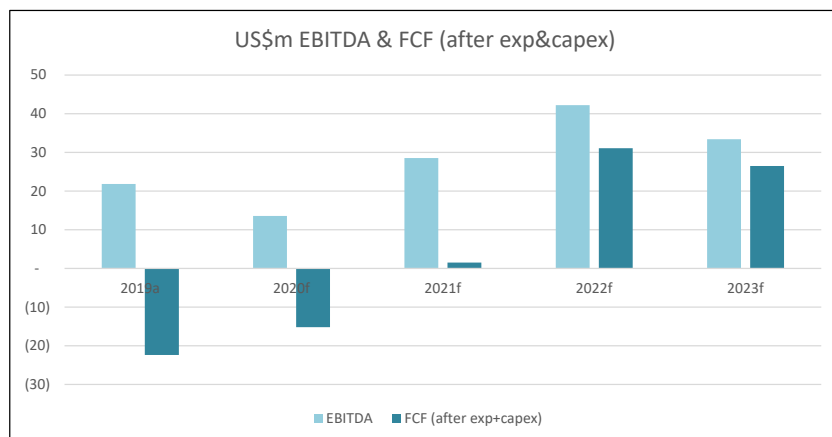
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- Hedge book – 440kbbbls to September 2022 via swaps, at a weighted average LLS price of ~\$51/bbl;
- Of which, 300kbbbls hedged in FY'21 ensures Op CF of US\$28m on our forecasts;
- This compares with the Company's current US\$29m EV (A\$40m);
- As at Jun 30, net debt of US\$4m, implies OEL will be net cash within 12mnths on a standstill basis;
- We anticipate appointment of a new MD-CEO shortly. We believe that the appointee will have experience in the Gulf of Mexico, aligning he/she with OELs strategy;
- To that end, we view the recent oil price collapse, will enhance the opportunity set and deal flow;
- With Green Canyon on stream, this places OEL in a very good position to undertake accretive growth oriented transactions;
- We view that the Green Canyon risks are now behind OEL;
- Further to which, the hedge book provides material downside protection to material earnings upgrades;
- Consequently, we upgrade recommendation to Buy (from Speculative Buy);
- Our Valuation is unchanged (3.1cps) as is our 3cps Price Target.

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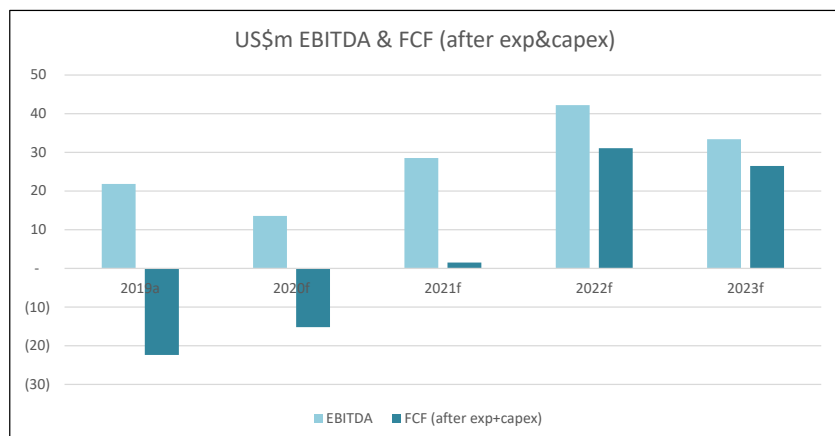
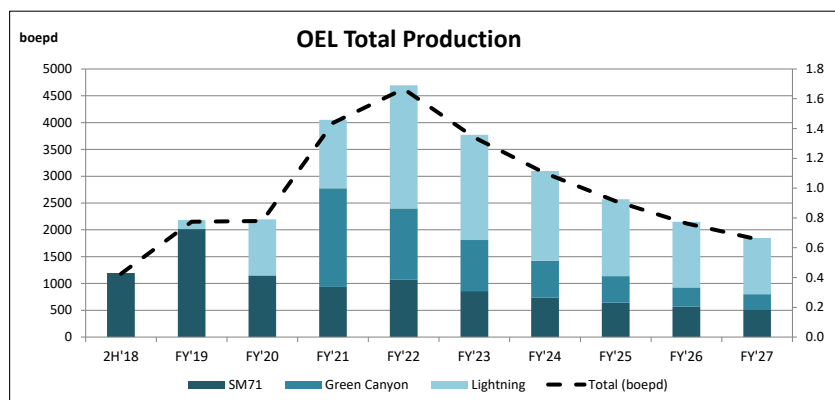
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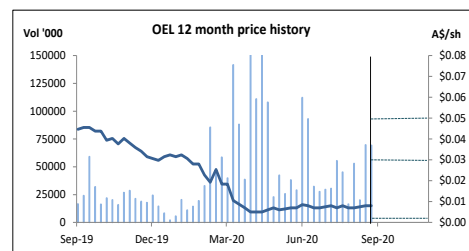
Key Variables

| Val/ Sh | WTI Oil Price/bbl | | | | | | | | | |
|---------|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| | 0.031 | -20% | -15% | -10% | -5% | 0% | 5% | 10% | 15% | 20% |
| AUDUSD | 15% | \$0.022 | \$0.023 | \$0.024 | \$0.026 | \$0.027 | \$0.029 | \$0.030 | \$0.031 | \$0.033 |
| | 10% | \$0.023 | \$0.024 | \$0.025 | \$0.027 | \$0.028 | \$0.030 | \$0.031 | \$0.033 | \$0.034 |
| | 5% | \$0.024 | \$0.025 | \$0.027 | \$0.028 | \$0.030 | \$0.031 | \$0.033 | \$0.034 | \$0.036 |
| | 0% | \$0.025 | \$0.026 | \$0.028 | \$0.030 | \$0.031 | \$0.033 | \$0.035 | \$0.036 | \$0.038 |
| | -5% | \$0.026 | \$0.028 | \$0.029 | \$0.031 | \$0.033 | \$0.035 | \$0.036 | \$0.038 | \$0.040 |
| | -10% | \$0.028 | \$0.029 | \$0.031 | \$0.033 | \$0.035 | \$0.037 | \$0.039 | \$0.041 | \$0.043 |
| -15% | \$0.029 | \$0.031 | \$0.033 | \$0.035 | \$0.037 | \$0.039 | \$0.041 | \$0.043 | \$0.044 | |



| Euroz Forecast | FY'18 | FY'19 | FY'20 | FY'21 | FY'22 | FY'23 |
|----------------------|--------|--------|--------|--------|--------|--------|
| Sales Gas TERM (A\$) | \$3.24 | \$2.79 | \$2.09 | \$1.75 | \$2.00 | \$2.00 |
| LLS US\$/bbl | \$62 | \$67 | \$52 | \$50 | \$65 | \$65 |
| AUDUSD | \$0.78 | \$0.74 | \$0.67 | \$0.70 | \$0.71 | \$0.72 |

Our Share Price Sensitivity



Our Market Sensitivity

Valuation - \$0.031/sh

Price Target - \$0.030/sh

Bull Scenario - \$0.050/sh

Oil prices rise beyond our long term US\$65/bbl forecast in the medium term and Green Canyon development is executed on time and budget. Exploration and appraisal activity is reinvigorated.

Base Scenario - \$0.030/sh

Oil prices recover to pre-crash levels; Lightning and SM71 continue to perform in line with recent levels; Green Canyon is delivered on time and budget.

Bear Scenario - \$0.002/sh

Low prevailing oil prices remain and OEL is required to source additional equity capital in shore up the Balance Sheet to protect the business from any credit default risk.

Company Summary

Otto Energy Ltd (OEL) is a US Gulf Coast oil & gas exploration and production company. OEL currently on production, brownfields appraisal and exploration of conventional shallow water and onshore oil and gas fields.

SM71 (South Marsh Island) located in shallow GoM is OEL's first production asset, producing gross +1mmboe since commissioning in Mar'18. Current 50% working interest (NRI 40%) and net 2P reserves are -6.6mmboe (90% oil). The Lightning discovery (37.5% WI) commenced commercial sales from Jun Q, 2019.

Disclaimer

The projections and information above is based on the set assumptions outlined. Due care and attention has been used in the preparation of this information. However actual results may vary from forecasts and any variation may be materially positive or negative. Forecasts by their very nature, are subject to uncertainty and contingencies, many of which are outside the control of Euroz.

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Market Statistics Year End 30 June

| | | | | |
|------------------------------|----------------|---------------|---------------------|-------|
| Share Price | \$0.008 | A\$/sh | Directors | |
| Issued Capital | | | J Jetter | Chair |
| FP Ord* | 4,795.0 | m | G Page | NED |
| Opt. (var) | 42.5 | m | P Senyca | NED |
| Perf Rights | 46.8 | m | K Small | NED |
| Total Dil. FPOrd* | 4,841.8 | m | | |
| | | | Shareholders | |
| Market Capitalisation | \$39 | m | Molton Holdings Ltd | 48.1% |
| Enterprise Value | \$45 | m | | |
| Debt | -\$31 | m | | |
| Cash | \$25 | m | | |

*assumes A\$10.4m raised at \$0.006/sh

| Asset Valuation | US\$m | A\$m | A\$/sh |
|------------------------|--------------|-------------|---------------|
| South Marsh 71 | 45 | 69 | 0.014 |
| Lightning | 35 | 54 | 0.011 |
| Green Canyon | 31 | 47 | 0.010 |
| Corporate | (15) | (23) | (0.005) |
| Exploration | 5 | 8 | 0.002 |
| Hedging | 3 | 4 | 0.001 |
| Unpaid Capital | - | - | - |
| Debt | (21) | (31) | (0.006) |
| Cash | 17 | 25 | 0.005 |
| Total | 100 | 152 | 0.031 |

| F/Cast Production (US\$m) | 2019a | 2020f | 2021f | 2022f |
|----------------------------------|--------------|--------------|--------------|--------------|
| Attrib. Prod'n (mmbboe) | | | | |
| SM 71 | 0.73 | 0.41 | 0.34 | 0.39 |
| Lightning | 0.06 | 0.38 | 0.46 | 0.83 |
| Green Canyon | - | - | 0.66 | 0.48 |
| Total Gas (Bscf) | 1.23 | 2.53 | 3.87 | 5.61 |
| Total Oil-cond (mmbbls) | 0.73 | 0.44 | 0.86 | 0.79 |
| Total Attrib (mmbboe) | 0.79 | 0.79 | 1.46 | 1.69 |

Av. net Production (kbbboe/d Pre-royalty) **2.15** **2.16** **3.99** **4.63**

Op. Costs (inc. roy. & state tax) - \$/boe **14.11** **12.30** **11.39** **13.71**

| Assumptions | 2019a | 2020f | 2021f | 2022f |
|-----------------------------------|--------------|--------------|--------------|--------------|
| Avg LLS Oil Price (US\$/bbl) | 64.5 | 50.2 | 48.0 | 63.0 |
| Avg LLS Oil Price Rec'd (A\$/bbl) | 59.5 | 43.2 | 41.0 | 56.0 |
| Avg Henry Hub Price (A\$/GJ) | 2.8 | 2.1 | 1.8 | 2.0 |
| US\$:A\$ | 0.74 | 0.67 | 0.70 | 0.71 |

| Ratio Analysis (US\$m) | 2019a | 2020f | 2021f | 2022f |
|-------------------------------|--------------|--------------|--------------|--------------|
| CF (US\$m) | 21 | 14 | 28 | 43 |
| CF / Sh (Ac/sh) | 1 | 0 | 1 | 1 |
| CF Ratio (x) | 4.1 | 1.8 | 1.0 | 0.6 |
| Earnings (A\$m) | (25) | (0) | 16 | 26 |
| EPS (Ac/sh) | (1.0) | (0.0) | 0.3 | 0.5 |
| EPS Growth (%) | na | na | na | 61% |
| Earnings Ratio (x) | na | na | 2 | 1 |
| E'prise Val. (A\$m) | 153 | 61 | 57 | 12 |
| EV : EBITDA (x) | 2.1 | 3.0 | 1.4 | 0.2 |
| EV : EBIT (x) | (2.4) | 66.3 | 3.3 | 0.5 |
| Net Debt / ND+Eq (%) | na | 2% | 1% | na |
| Interest Cover (x) | na | 16.5 | 56.7 | na |
| EBIT Margin (%) | na | 3% | 30% | 33% |
| ROE (%) | -50% | 0% | 21% | 26% |
| ROA (%) | -43% | 1% | 16% | 22% |

| | | | | |
|-------------------|---|---|---|---|
| Div. (Ac/sh) | - | - | - | - |
| Div. payout ratio | - | - | - | - |
| Div. Yield | - | - | - | - |
| Div. Franking | - | - | - | - |

| Profit and Loss (US\$m) | 2019a | 2020f | 2021f | 2022f |
|--------------------------------------|--------------|--------------|--------------|--------------|
| Oil Equivalent Sales | 42 | 28 | 46 | 69 |
| LESS Royalties | (8) | (5) | (9) | (13) |
| Hedging impact | (0) | 2 | 3 | - |
| Deferred Revenue | (2) | (1) | - | - |
| Interest Revenue | 0 | 1 | 0 | 0 |
| Other Revenue | - | - | - | - |
| TOTAL REVENUE | 31 | 24 | 41 | 57 |
| Operating Costs | 4 | 4 | 8 | 10 |
| Dep/Amort | 4 | 3 | 17 | 19 |
| Writeoffs (explor) | 38 | 8 | - | 5 |
| Corp O/H | 5 | 6 | 4 | 4 |
| Provisions | (1) | 2 | - | - |
| EBITDA | 22 | 14 | 29 | 42 |
| EBIT | (19) | 1 | 12 | 18 |
| Interest Expense | - | 1 | 1 | 0 |
| NPBT | (18) | (0) | 11 | 19 |
| Tax | - | - | - | - |
| NPAT | (18) | (0) | 11 | 19 |
| Minority Interest | - | - | - | - |
| NET PROFIT | (18) | (0) | 11 | 19 |
| Net Abnormal Profit/(Loss) after Tax | - | - | - | - |
| Net Profit After Abnormal | (18) | (0) | 11 | 19 |

| Cash Flow (US\$m) | 2019a | 2020f | 2021f | 2022f |
|--------------------------------|--------------|--------------|--------------|--------------|
| + Net Profit | (18) | (0) | 11 | 19 |
| + Working Capital Adjustment | (1) | 1 | - | - |
| + Dep/Amort | 4 | 3 | 17 | 19 |
| + Provisions, W/O | 37 | 10 | - | 5 |
| + Tax Expense | - | - | - | - |
| - Tax Paid | - | - | - | - |
| - Deferred Revenue | - | (1) | - | - |
| = Operating Cashflow | 21 | 14 | 28 | 43 |
| -Capex + Development | 6 | 22 | 27 | 5 |
| -Exploration | 37 | 8 | - | 6 |
| -Assets Purchased | - | - | - | - |
| +Asset Sales | - | - | - | - |
| +Other | (1) | - | - | - |
| = Investing Cashflow | (44) | (30) | (27) | (11) |
| + Equity Issues (Rts,plc,opts) | 37 | 8 | - | - |
| +Loan Drawdown/Receivable | - | 22 | - | - |
| +Other | (2) | (1) | - | - |
| -Loan Repayment | 11 | 6 | 12 | 7 |
| -Dividends | - | - | - | - |
| = Financing Cashflow | 24 | 24 | (12) | (7) |
| Period Surplus | 1 | 9 | (10) | 24 |
| Adj. FX effects | - | - | - | - |
| CASH | 7 | 17 | 6 | 30 |

| Balance Sheet (US\$m) | 2019a | 2020f | 2021f | 2022f |
|------------------------------|--------------|--------------|--------------|--------------|
| Assets | | | | |
| Cash | 7 | 17 | 6 | 30 |
| Current Receivables | 3 | 2 | 2 | 2 |
| Other Current Assets | 1 | 1 | 1 | 1 |
| Non-Current Assets | 31 | 55 | 65 | 51 |
| Total Assets | 43 | 75 | 75 | 85 |
| Liabilities | | | | |
| Borrowings | - | 19 | 7 | - |
| Current Accounts Payable | 5 | 8 | 8 | 8 |
| Non-Current Liabilities | 0 | 3 | 3 | 3 |
| Other Liabilities | 2 | 2 | 2 | 2 |
| Total Liabilities | 6 | 32 | 20 | 13 |
| Net Assets | 37 | 43 | 55 | 72 |

Reserves and Resources

| | Oil | Gas | Total |
|----------------------------------|---------------|------------|--------------|
| | mmbbls | Bcf | mmboe |
| 2P (Net Revenue Interest) | | | |
| SM71 | 4.90 | 3.10 | 5.4 |
| Lightning | 0.34 | 11.4 | 2.2 |
| Green Canyon | 1.6 | 1.6 | 1.8 |
| Total | 6.8 | 16.1 | 9.5 |
| EV / 2P boe (A\$) | | | 5.9 |
| EV / 2P+2C boe (A\$) | | | 5.9 |

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