

Madagascar Oil[#]

BBG Ticker: MOIL LN

Price: 7.15p

Mkt Cap: £46.6m

BUY

Year to Dec	Revenue (US\$m)	EBITDA (US\$m)	PBT (US\$m)	EPS (US\$)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)
2013A	0.0	(12.0)	(12.1)	(0.02)	n/m	n/m	n/m
2014E	8.1	(12.2)	(12.3)	(0.02)	12.1	n/m	n/m
2015E	6.1	(19.2)	(19.3)	(0.02)	16.0	n/m	n/m
2016E	61.4	(3.4)	(3.6)	(0.00)	1.6	n/m	n/m

SOURCE: Company, VSA Capital estimates.

Jefferies Appointed as Advisor to MOIL

Madagascar Oil (MOIL)[#] has appointed Jefferies as an advisor to the company to assist in the process of bringing in a strategic partner to work with the company on its giant Tsimiroro field which has at least 1.7bn bbl of contingent resources. We have held the view that MOIL would find a partner for this strategically important project for some time, and now the appointment of Jefferies will enable MOIL to secure the correct strategic partner/s for a field of this magnitude. In 2008 Jefferies worked with MOIL to secure the farm-out of the Bemolanga licence to French major Total (FP FP), in a deal worth over US\$100m.

MOIL has confirmed it remains in dialogue with a number of potential partners and it is envisaged that the appointment of Jefferies will enable Madagascar Oil to access a wider pool of potential partners and has now reached the stage where a farm down is appropriate having secured the Development plan approval. MOIL is confident of a successful conclusion to this process before the end of 2015.

Significant Potential Value Uplift Over Time

There has been an abundance of investor interest surrounding the potential value of MOIL's Tsimiroro project. Therefore, we have conducted some illustrative analysis of potential value uplift on a yearly basis through to 2030, whilst considering the different stages of funding.

Should MOIL reach its three funding milestones for the project, it should be able to successfully develop the full field, with potentially significant value uplift along the way. This illustrative analysis suggests MOIL could be worth over £1 per share and £2 per share in 2022 and 2029, respectively. **This analysis is purely illustrative and does not impact on our price target.**

Recommendation and Target Price

A year on from the downturn in oil prices, which has disturbed the whole of the sector, MOIL has remained operationally strong as it builds momentum towards its production phase. The development of this project remains commercially viable on a long-term Brent price of US\$40-60/boe. **We have a BUY recommendation and a 35p TP.**

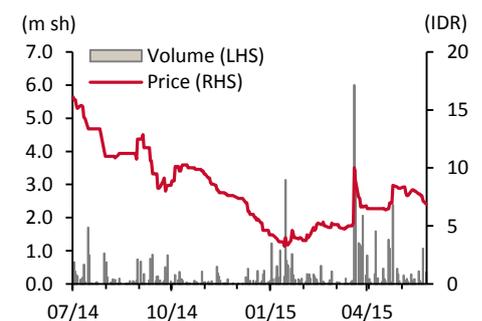
[#]VSA Capital acts as Corporate Adviser to Madagascar Oil.

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Company Description

Madagascar Oil is an E&P company with undeveloped assets onshore Madagascar.

One Year Price Performance



Price % chg	1mn	3mn	12mn
	2.1%	43.0%	-56.0%
12mn high/low:	16.38p/3.25p		

SOURCE: FactSet, as of 19 June 2015 close.

Market:	LSE AIM
Price target:	35p
Shares in issue:	652m
Net cash (2015E):	0.5m
Enterprise value:	60.2m
Next news:	2014 Annual Results

Major shareholders

Benchmark Advantage	32%
Outrider Management	29%
SEP African Ventures	23%

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Valuation

We value MOIL using a SOTP model, with our current target price derived from the Phase 1 development and its risked 2C contingent resources, which we assume a conservative recovery rate of 30% when compared to the company's value of 40% recovery. However, we currently assign no value to the exploration blocks (3105/3106/3107) as there is no planned programme, although the company has indicated it plans to undertake seismic on the Tsimiroro South and Tsimiroro Deep South blocks (part of 3104) in 2016. We assume a Brent price of US\$60/boe until 2017, with US\$70/boe from 2018 onwards; a US\$1.50/£1.00 exchange rate and a 7% WACC.

NAV Table

Prospects	Unrisked (mboe)	Equity (%)	CoS (%)	Net risked (mboe)	EMV (US\$m)	Net risked/share (p)	Potential upside/share (p)
Tsimiroro Phase 1	20	100%	70%	14	8	0.3	0
Tsimiroro remaining	488	100%	30%	147	765	34.0	80
Exploration 3105/3106/3107	-	100%	-	0	0	0.0	0
Financing	-	-	-	-	4	0.2	-
Total	508			161	777	35	80

SOURCE: Company data, VSA Capital estimates.

Potential Equity Valuation Over Time

Background

We have received investor interest around the potential value uplift as the field moves into development. Therefore, below we show some illustrative analysis of potential value on a yearly basis through to 2030, whilst considering the different stages of funding.

There are four critical milestones to the project (the first three involve funding based on discussions with management) that should lead to the full field development and potentially significant value uplift.

- Current (2015) - We estimate this phase will require US\$30m funding in 2015 and will enable the company to commence the first phase of development.
- Phase 1 (2016-2018) - The company will require in the region of US\$300m of funding during this phase which will be used to ramp the field up to a plateau production rate of 10kboe/d by 2018. The company plans to drill a well every four days on average during phase 1. We assume this funding would be provided by a strategic investor.
- Phase 2 (2018-21) – In this phase, MOIL plans to increase production further up to a plateau rate of 50kboe/d by 2021 and complete the construction of a 120km oil pipeline which will link the Tsimiroro Block to the west coast of Madagascar, where the oil will be loaded onto ships ready for export. This phase is, understandably, particularly capital intensive and requires in the region of US\$700m funding, although this may be lower in due course depending upon the nature of the funding structures and /or Partner(s). We assume there would be a broad cross-section of parties that would be interested in funding this stage, including infrastructure funds, oil traders, etc.
- Free Cash Flow Positive (2021-2030) – At this point the company plans to be producing enough oil to become free cash flow positive. This allows the project to continue to grow in equity value from 2021 onwards and beyond the peak production rate of 100kboe/d in 2026 due to the generation of surplus free cash flow. At this stage we would expect the company to consider a dividend strategy for shareholders.

This analysis is purely illustrative and is not linked to our current target price. We should stress that all prices are also purely illustrative based off recent prices. We expect the share price to react positively to the Jeffries news thus potentially raising any illustrative prices.

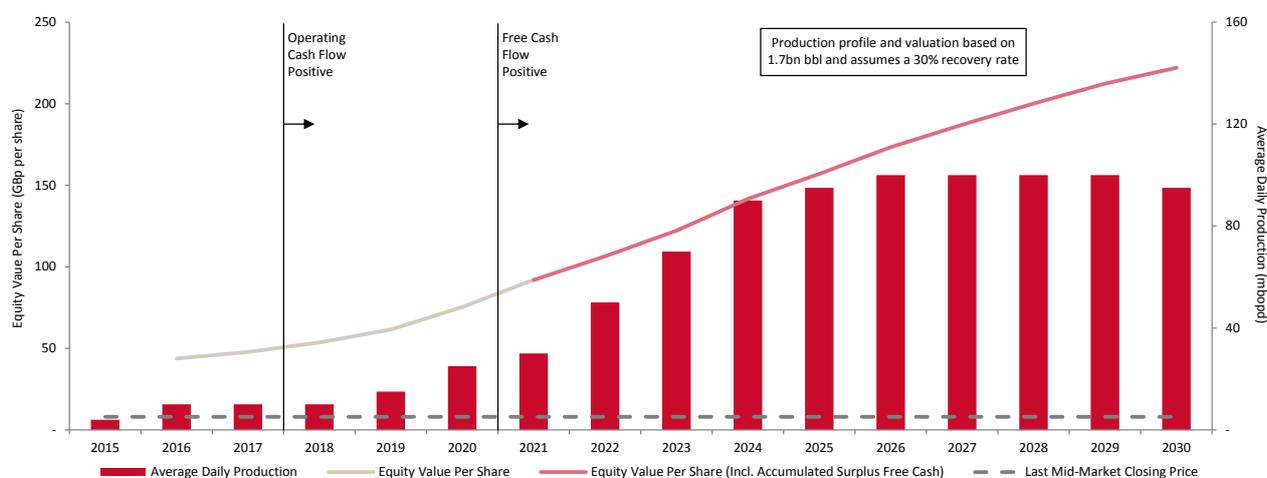
Data and Assumptions

Year	2015	2016-2018	2018-2021	2021-2024	2025-2030
Key Milestones	Current	Phase1 "Anchor Stage"	Phase 2 "Fast-Track Stage"	Free Cash Flow Positive	
Target 2C Resource (bbl)	1.7bn	1.7bn	2.2bn	2.5bn	2.5bn
Target 2P Reserves (bbl)	-	-	100m	250m	500m+
Brent Oil Price (US\$/bbl)	60	60	70	70	70
Assumed Phase 1 CoS	70%	70%	90%	n/a	n/a
Assumed Phase 2 CoS	30%	40%	70%	75%	75%
Funding Required (US\$m)	30	300	700	n/a	n/a
Assumed Funding Mix					
Equity	100%	70%	10%	n/a	n/a
Debt/Other	0%	30%	90%	n/a	n/a
Assumed Issue Price	6.25p	20p	30p	n/a	n/a

SOURCE: Company data and VSA Capital Estimates. The above data and assumptions are what we have used to derive our project equity value and is the input data for the equity value chart below.

- Current (2015) - Assumes an equity raise of US\$30m in 2015 at 6.25p/share; a 10% discount to its last closing price and an increased discount to the US\$20m placing completed by the company in 2H2014.
- Phase 1 (2016-2017) - Assumes funding in 2016 of US\$300m, is backed by the strategic partner(s) at 20p/share which we believe will be brought in by the Jeffries competitive process; whilst this currently represents a premium to MOIL's share price we believe there is a precedent that a strategic partner would pay such a premium. In August 2013 **Maurel et Prom (MAU FP)** entered into a strategic deal with **Deep Well Oil & Gas (DWOG US)**, a Canadian oil sands play, by making a US\$22m equity investment at 48.8 cents per share, a 10x premium to the 1 month VWAP, in addition to US\$150m of earn-ins. We feel this justifies our 20p/share price for a strategic investor, which should be based more on fundamental value as opposed to the current market value. The table below outlines the potential returns at each year of the project under this scenario and how it can be altered.
- Phase 2 (2018-20) – Assumes US\$700m raised at 30p/share in 2018 and is the final stage of funding required for the project, as by 2021 MOIL is accumulating surplus cash from its production which should be available for dividend payments or further investment.

Equity Value at the Beginning of Each Year of the Tsimiroro Project



SOURCE: Company, VSA Capital estimates. This illustrative analysis suggests MOIL could be worth over £1/sh and £2/sh in 2022 and 2029 respectively.

Our analysis shows there is significant potential value uplift for an investor that participates in our anticipated 2015 fundraising at our assumed price of 6.25p, based all our assumptions and if MOIL successfully meets its funding milestones.

This suggests MOIL could be worth over £1 per share and £2 per share in 2022 and 2029, respectively.

Assessed Equity Value and Potential Investor Returns (Including Surplus Cash Flow)

Phase	Investing Year	Exit Year	Entry Price (Assumed 2015 Fundraising) (GBP/share)	Exit Price (Assessed Equity Value) (GBP/share)	Return Multiple (x)	Annualised Return (% pa)
Current	2015					
Phase 1: Anchor Stage	2015	2016	6.25	42.0	6.7x	572%
	2015	2017	6.25	45.7	7.3x	170%
Phase 2: Fast-track Stage	2015	2018	6.25	52.0	8.3x	103%
	2015	2019	6.25	59.7	9.6x	76%
	2015	2020	6.25	73.0	11.7x	63%
Free Cash Flow Positive	2015	2021	6.25	89.1	14.3x	56%
	2015	2022	6.25	103.2	16.5x	49%
	2015	2023	6.25	118.5	19.0x	44%
	2015	2024	6.25	137.3	22.0x	41%
	2015	2025	6.25	152.2	24.4x	38%
	2015	2026	6.25	168.1	26.9x	35%
	2015	2027	6.25	181.4	29.0x	32%
	2015	2028	6.25	194.1	31.0x	30%
	2015	2029	6.25	205.9	32.9x	28%
	2015	2030	6.25	215.3	34.4x	27%

SOURCE: VSA Capital estimates

Sensitivity Analysis of 2016 Fundraise Involving a Strategic Investor

		Equity Funding as % Fundraising (Phase 1: Anchor Stage in 2016)						
		40%	50%	60%	70%	80%	90%	100%
Issue Price (GBP Per Share)	14.0	41.6	39.3	37.3	35.6	34.2	32.9	31.8
	16.0	43.6	41.4	39.6	38.0	36.6	35.4	34.3
	18.0	45.3	43.3	41.6	40.1	38.8	37.6	36.6
	20.0	46.7	44.9	43.4	42.0	40.7	39.6	38.7
	22.0	48.0	46.4	44.9	43.6	42.5	41.4	40.5
	24.0	49.1	47.6	46.3	45.1	44.0	43.1	42.2
	26.0	50.1	48.7	47.5	46.4	45.4	44.6	43.7

SOURCE: VSA Capital estimates

We see the introduction of a strategic investor and the 2016 fundraise as the most critical stage of funding for the Tsimiroro project. We believe this to be more important than the 2018 raise to build pipeline infrastructure, as our analysis estimates that MOIL will be producing 10kboe/d and have 100mboe of 2P reserves in 2018, enough to attract sufficient investor and bank interest by itself.

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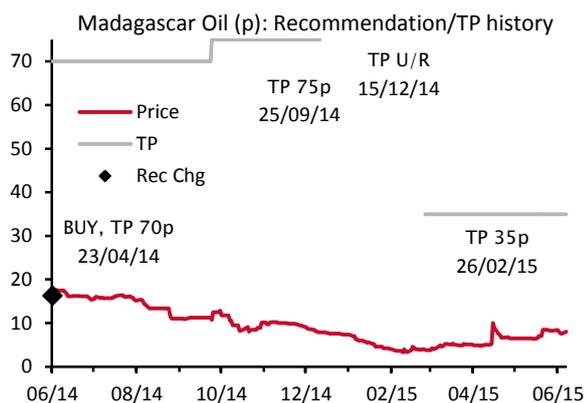
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Equities breakdown: 31 March 2015	Spec. BUY	BUY	HOLD	SELL
Overall equities coverage	23.8%	71.4%	4.8%	0.0%
Companies to which VSA has supplied investment banking services	28.6%	71.4%	0.0%	0.0%

Recommendation and Target Price History



SOURCE: FactSet data, VSA Capital estimates.

Valuation basis

We value MOIL using our SOTP model while allocating zero value to the exploration blocks, since there is no programme planned on these assets as yet. We assume a Brent price of US\$60/boe until 2017, with US\$70/boe from 2018 onwards. We also assume, a US\$1.50/£1.00 exchange rate and a 7% WACC.

Risks to that valuation

Risks include oil price fluctuations and production delays.

This recommendation was first published on 23 April 2014.

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