Canadian Overseas Petroleum

Nigerian acquisition

Diversifying asset base

Oil & gas

Canadian Overseas Petroleum (COPL) has acquired an 80% interest in Essar Nigeria through its joint venture with Shoreline, ShoreCan. Essar Nigeria owns a 100% operated interest in OPL 226, a shallow water licence in Nigeria containing the Noa West oil discovery (16.1mmbbls 2C gross) and the Noa Complex, which is estimated to contain mid-case prospective oil resources of 461mmbbls. We now include a risked notional 200mmbl oil development for OPL 226 in our RENAV; combining this with FX adjustments and dilution from in-the-money warrants drives an increase in our RENAV from 8.5p/share (C$0.15 /share) to 15.3p/share (C$0.26/share).

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	Net cash (US$m)	Capex (US$m)
12/14	0.0	(7.7)	(6.6)	4.7	(0.5)
12/15	0.0	(6.5)	(7.8)	2.0	(0.2)
12/16e	0.0	(6.5)	(6.7)	2.3	(0.2)
12/17e	0.0	(5.5)	(5.4)	4.5	0.0**

Note: *PBT is normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Assuming farm-out of OPL 226.

ShoreCan acquires 80% of Essar Nigeria

COPL has added diversification to its asset base, with ShoreCan completing the acquisition of an 80% interest in Essar Nigeria in September 2016. The JV's core asset is OPL 226; a licence containing the Noa West oil discovery, as well as prospective oil resource in the Noa Complex. The acquisition adds a relatively low geological risk, shallow water exploration/appraisal asset to the COPL portfolio. Importantly, COPL has greater control over the pace of activity in Nigeria than Liberia, LB-13, where the company retains a carried (ExxonMobil operator) exploration interest in the 400mmbbl Mesurado-1 prospect.

Forward programme and funding

We expect ShoreCan to drill a well on OPL 226 in 2017/18 targeting a crestal location within the Noa Complex. Potential exists for thicker sand pay than the 18.7m of oil discovered at Noa-1. Prospects have been de-risked by five offset wells, 3D seismic and the use of several advanced AVO techniques that COPL believes help differentiate oil-bearing sands from gas or water. We expect an exploration well on OPL 226 and ongoing SG&A to be funded through a combination of existing cash ($5.2m at end Q216), cash inflow from the exercise of outstanding options, equity and/or farm-down. Estimated gross well costs for OPL 226 are US$28m, $11.2m net to COPL.

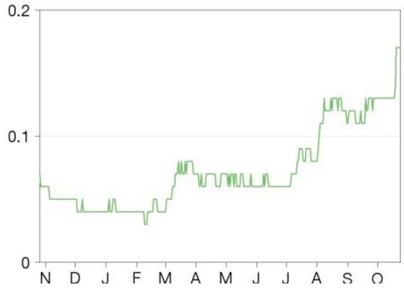
Valuation: Increase in RENAV

Our RENAV assumes COPL farms down its equity interests in Liberia, LB-13 and Nigeria, OPL 226, in the event of exploration success (farminee requiring a 20% IRR). Assuming dilution of working interest and value through farm-down, we estimate a RENAV of 15.3p/share or C$0.26/share. On an 'undiluted' basis, simply assuming $NPV_{12.5}$ asset values, this rises to 19.6p/share or C$0.34/share.

25 October 2016

Price	**C$0.17**
Market cap	**C$103m**
	US$0.75/C$ £/$ 1.3
Net cash (US$m) at 30 June 2016	5.2
Shares in issue (basic)	606.3m
Free float	99%
Code	XOP/COPL
Primary exchange	TSX-V
Secondary exchange	LSE

Share price performance



%	1m	3m	12m
Abs	32.0	83.3	135.7
Rel (local)	30.0	79.4	120.4
52-week high/low		C$0.17	C$0.03

Business description

Canadian Overseas Petroleum (COPL) is an Africa-focused E&P with exploration assets in Liberia and Nigeria (through its ShoreCan JV). COPL is carried through a US$120m gross exploration programme in Liberia by ExxonMobil.

Next events

Spud Mesurado - 1 Liberia	Q416

Analysts

Sanjeev Bahl	+44 (0)20 3077 5700
Elaine Reynolds	+44 (0)20 3077 5713

oilandgas@edisongroup.com

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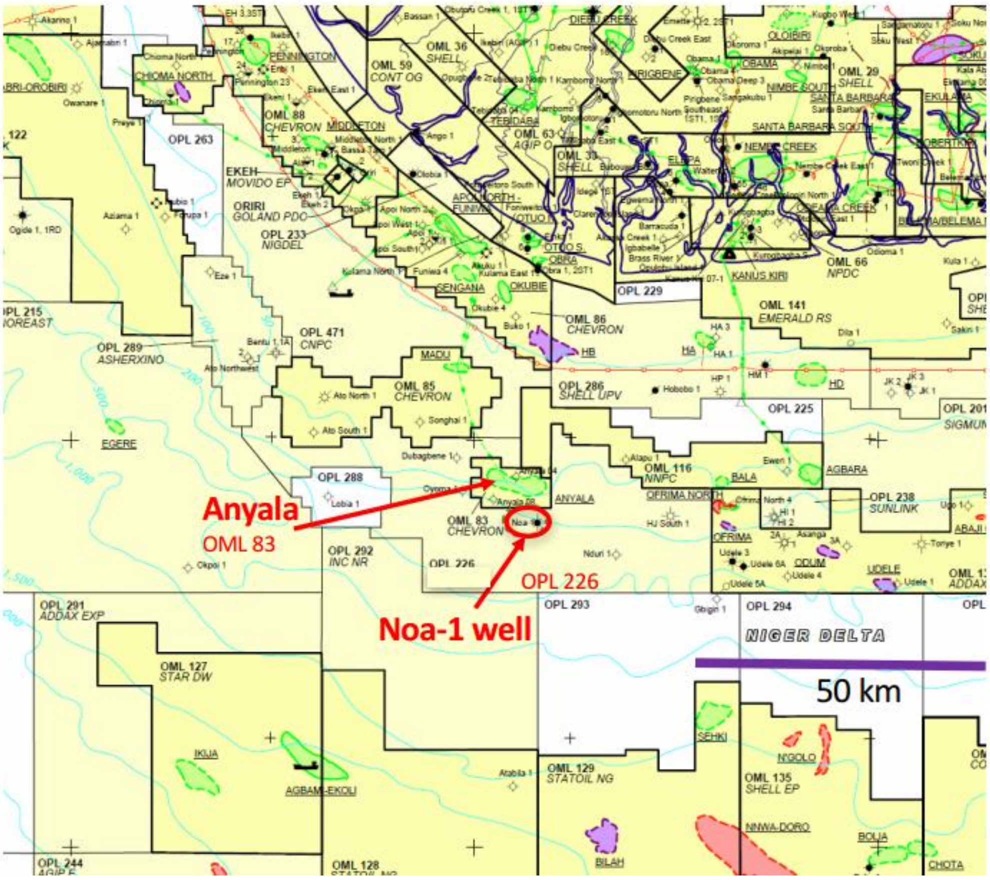
Diversifying asset base

On 14 September 2016, COPL announced that its 50%-owned affiliate, ShoreCan, had completed the acquisition of 80% of the share capital of Essar Nigeria. Essar Nigeria's sole asset is a 100% interest and operatorship of OPL 226 Nigeria. We believe the addition of OPL 226 brings asset diversity, portfolio depth and, importantly, control. The acquired asset provides shareholders with exposure to low-risk exploration/appraisal upside in Nigeria, as well as higher-risk/impact exploration offshore Liberia. Importantly, COPL will have control over the pace of activity on OPL 226 through the ShoreCan JV.

OPL 226: Asset description

OPL 226 is located 50km offshore in the central delta region of Nigeria and in shallow water ranging between 40m and 180m. The block covers an area of 1530km^2 and benefits from extensive seismic data, including 1,750km^2 of 2D seismic and 1,300km^2 of 3D. Five wells have been drilled on the block and an oil discovery was made in 2001 with the last of these wells, Noa-1.

Exhibit 1: Location of Noa-1

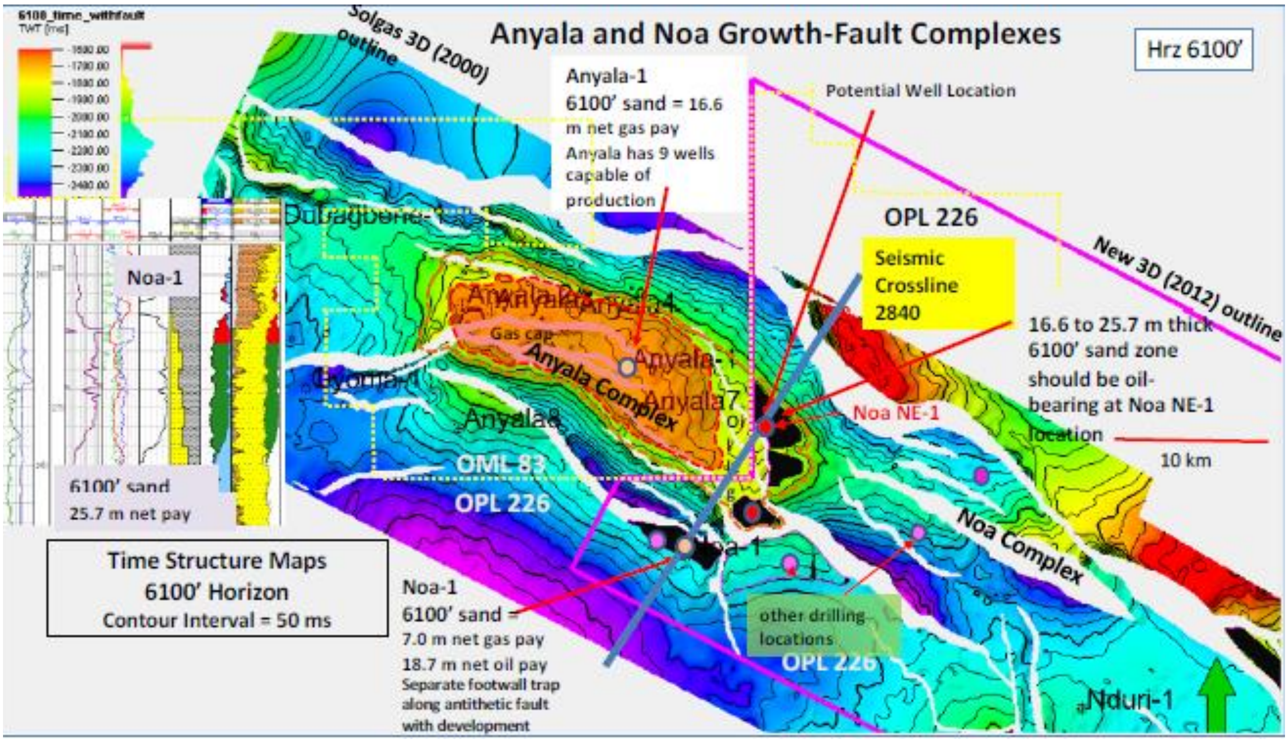


Source: COPL

OPL 226 has generally been thought to be gas bearing (even though oil was encountered in two wells in nearby Anyala) and has historically been underexplored. This has been exacerbated by poor-quality seismic data sets due to the presence of thick soft deposits of mud on the seabed. The block sits on a large-growth, fault-controlled structural complex running in a NW-SE direction and known within the company as the Noa Complex. The Noa Complex benefits from the presence of five wells that can be used to calibrate the 3D seismic and COPL has applied the advanced AVO techniques of extended elastic impedance (EEI) and Joint impedance & Facies inversion (Ji-Fi) to the most recent 568km^2 3D survey acquired by Essar Energy in 2012. Based on this detailed technical work, COPL has identified a number of anomalies associated with sand lithology and oil fluid content that tie in with structural and stratigraphic features. Although the Noa Complex is adjacent to the Anyala Complex in OML 83, the company believes that the two areas are isolated from each other by a fault.

The area of initial focus for COPL will be in the vicinity of the Noa-1 discovery well at the western edge of the block. Noa-1 was the only well drilled in the block on 3D seismic and it encountered 20m of good-quality sand typical of the Tertiary sands of the Niger Delta, with porosities around 30% and permeabilities between 800mD and 5D. However, Noa-1 was drilled on the flank of the structure and COPL expects that the sands will be thicker in the crestal part of the field. Producing fields in the Niger Delta can have compartmentalised sands with different oil-water contacts (OWC), but they are also thick and tend to have the same drive mechanism.

Exhibit 2: Anyala and Noa time structure map 6,100ft horizon



Source: COPL

The company has identified a drilling location around 2km from the discovery well, which would target this crestal area to prove the presence of oil in the thickest part of the structure. COPL plans to design the well to be completed as a production well, which can then be brought on stream as part of an early production system (EPS) in the case of success. Under the terms of the PSC, there is a commitment to drill one well by December 2017.

OPL 226 has been independently assessed by Netherland, Sewell & Associates (NSAI) as of March 2016. The primary Noa West discovery is estimated to contain gross unrisked 2C resources of 16mmbbls. A further 15 undrilled prospects across the Noa Complex have been assigned gross best estimate prospective resources of 461mmbbls, with a high case of 808mmbbls. In addition, prospective gas resources on the block are estimated at 1.7tcf on a best estimate basis. It should be noted that NSAI's estimate is based on the 20m sand thickness encountered in Noa-1, so that there is upside to these figures if COPL can demonstrate thicker sands in the crestal area in line with its current models.

The majority of the resources assessed by NSAI sit within the Noa Complex. Once this area has been investigated, the company sees potential for substantial upside to these figures in the foot wall area of the licence to the north-east of Noa-1, where it has identified multiple prospects.

OPL 226: Development assumptions

We base our risked valuation of OPL 226 on the notional development of a gross 200mmbl oil field, a subset of prospective resource within the Noa Complex. Noa sits in relatively shallow water with depths ranging from 50m to 180m; we assume a jack-up based production platform and tanker offload from a single buoy mooring. Key inputs that drive our economic modelling are highlighted below.

Exhibit 3: OPL 226 development key assumptions

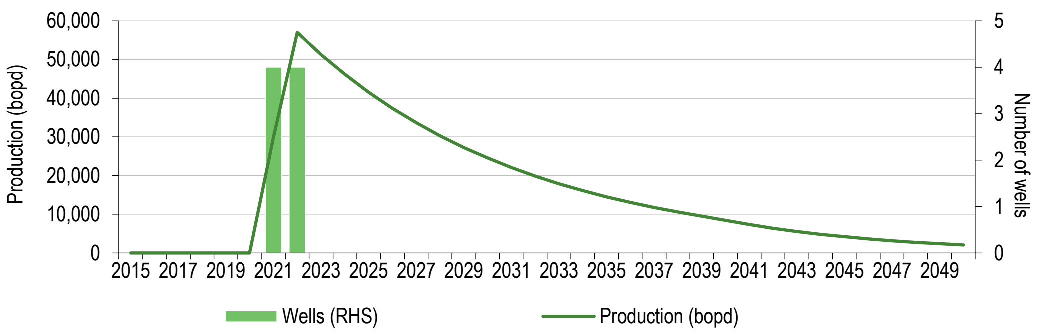
OPL 226	
Opex ($/bbl)	12.8
Capex ($/bbl)	11.8
Gross prospect size (mmbbls)	200
Completed well cost ($m)	28
Gross project IRR	39%
First oil	2020
Plateau production rate (mb/d)	57,000
Gross value per bbl ($/bbl)	2.43

Source: Edison Investment Research

In addition to the key assumptions in Exhibit 3, we assume first oil in 2020 with production from eight development wells driving peak production of 57mb/d. Our analysis indicates a gross project IRR of 39% at US$70/bbl long-term and an $NPV_{12.5}$ break-even oil price of US33$/bbl.

We note that the terms of the OPL 226 PSC, signed by Essar Nigeria, are typical of Nigerian contracts, which are subject to high levels of government take. Key elements of the PSC include royalty, cost recovery, tax oil and contractor profit share. While IRRs are strong, NPV per barrel is low in a global context. We model 2.43$/bbl at US$70/bbl Brent. We estimate total government take over the life of the contract at 95% (government share of revenues after all costs) based on our notional 200mmbbl development.

Exhibit 4: OPL 226 assumed production profile and well count



Source: Edison Investment Research

Assuming COPL farms out its equity interest in exchange for a development cost carry through to first oil, we estimate that net working interest would fall from 40% to 15.5% (farminee requiring a 20% IRR). Including cost-carry increases the net value per barrel, which rises from US$2.43/bbl to US$4.6/bbl reflecting the cost carry, partially offsetting this reduction in working interest.

OPL 226: Planned activity

ShoreCan is yet to firm up its work programme for OPL 226, but we expect the JV to look to drill at least one exploration well on the licence over the course of 2017/18. At current rig day rates, the company expects this well to cost c US$28m gross, which would equate to a net cost to COPL of US$11.2m.

Valuation and financials

As per our previous published research, we provide two valuation scenarios for COPL: firstly, a valuation made on the basis of COPL farming down its LB-13 and OPL 226 working interests in exchange for full development cost carries through to first oil. Key changes to our valuation since the last time we published include:

- the addition of OPL 226 on completion of ShoreCan's Essar Nigeria acquisition;
- a change in FX rates: C$:US$ from 0.77 to 0.75. £:US$ from 1.4 to 1.3; and
- the addition of all in-the-money stock warrants to diluted share count and cash on exercise to NAV.

Exhibit 5: COPL – Scenario 1 summary valuation assuming farm-down* and cost carry

Asset	Country	Diluted WI (pre back-in)	Catalyst	CoS	Recoverable reserves Gross	Recoverable reserves Net	NPV/boe	Net risked value	Value per share Risked	Value per share Risked
		%		%	mmboe	mmboe	US$/boe**	US$m	C$/share	p/share
Net (debt)/cash inc cash from in-the-money exercised warrants								22	0.04	2.0
SG&A								-11	-0.02	-1.1
Core NAV								10	0.02	1.0
Exploration (2016)										
Mesurado-1 (LB-13)	Liberia	7.7%		19.5%	409	32	9.2	57	0.09	5.3
Prospect 2 (LB-13)	Liberia	7.7%		19.5%	400	31	9.2	55	0.09	5.2
Noa (OPL 226)	Nigeria	15.5%		30.0%	191	30	4.6	41	0.07	3.8
RENAV								163	0.26	15.3

Source: Edison Investment Research. Note: *Farminee 20% IRR. **Includes impact of cost-carry.

Please see our note published on 2 August 2016 for further details of COPL's interest in LB-13, Liberia and asset valuation details.

We also provided an 'undiluted' valuation, which reflects the full $NPV_{12.5}$ risked value of the company's interests in Liberia and Nigeria. This valuation is more indicative of a CPR or 'high case' valuation and is a 28% premium to our farm-out RENAV. Nevertheless, under both scenarios we see material upside from the current share price.

Exhibit 6: COPL – Scenario 2 summary valuation

Asset	Country	Diluted WI (pre back-in)	Catalyst	CoS	Recoverable reserves Gross	Recoverable reserves Net	NPV/boe	Net risked value	Value per share Risked	Value per share Risked
		%		%	mmboe	mmboe	US$/boe	US$m	C$/share	p/share
Net (debt)/cash inc cash from exercised warrants								22	0.04	2.0
SG&A three years								-11	-0.02	-1.1
Core NAV								10	0.02	1.0
Exploration (2016)										
Mesurado-1 (LB-13)	Liberia	17.0%		19.5%	409	70	5.4	73	0.12	6.8
Prospect 2 (LB-13)	Liberia	17.0%		19.5%	400	68	5.4	71	0.12	6.7
Noa (OPL 226)	Nigeria	40.0%		30.0%	191	76	2.4	56	0.09	5.2
RENAV								210	0.34	19.6

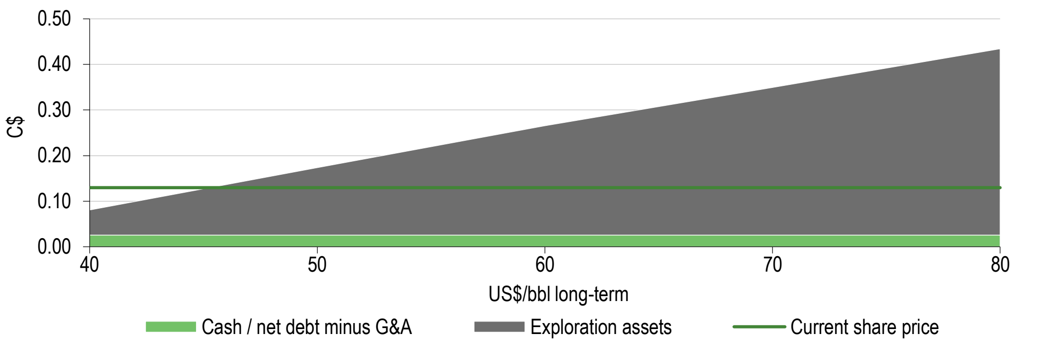
Source: Edison Investment Research

After an equity injection of c C$8m in Q216, COPL is funded to cover SG&A costs for 2016 and 2017 based on our forecasts. Liberia exploration is funded through a US$120m cost carry from partner ExxonMobil, which has the potential to cover COPL for a two-well programme. Recent statements from NOCAL and ExxonMobil suggest that the Mesurado-1 prospect (estimated gross unrisked c.400mmboe) is likely to be spud in November/December 2016, COPL guidance remains Q416. Please see our last published note 'Liberia – looking for Liza's conjugate' for further details.

We expect ShoreCan to look at funding options to drill one well on OPL 226 in 2017/18 at a net cost of US$11.2m. One option to fund this cost would be from cash inflow from the exercise of in-the-money stock options. If all in-the-money options were exercised, we could expect c U$16m of cash inflow over the course of 2017/18.

We provide a valuation sensitivity to long-term oil price assumptions in the graph below. We note that this is on the basis of $NPV_{12.5}$ asset values excluding the dilutive impact of farm-downs.

Exhibit 7: RENAV sensitivity to oil price (Scenario 2)



Source: Edison Investment Research

Exhibit 8: Financial summary

US$'000s	2013	2014	2015	2016e	2017e
December	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	(9,166)	(7,685)	(6,505)	(6,476)	(5,468)
Operating Profit (before amort. and except.)	(9,225)	(7,747)	(6,564)	(6,514)	(5,486)
Intangible Amortisation	0	0	0	0	0
Exceptionals	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	(9,225)	(7,747)	(6,564)	(6,514)	(5,486)
Net Interest	23	28	41	59	62
Forex gains/(losses)	729	1,138	(530)	(248)	0
Derivative gain/(losses)	0	27	1,097	(259)	0
Share in jvs/associates	0	0	(729)	(2)	0
Profit Before Tax (norm)	(8,473)	(6,581)	(7,782)	(6,705)	(5,423)
Profit Before Tax (FRS 3)	(8,473)	(6,554)	(6,685)	(6,964)	(5,423)
Tax	0	0	0	0	0
Profit After Tax (norm)	(8,473)	(6,581)	(7,782)	(6,705)	(5,423)
Profit After Tax (FRS 3)	(8,473)	(6,554)	(6,685)	(6,964)	(5,423)
Average Number of Shares Outstanding (m)	301.9	365.2	440.5	575.3	648.7
EPS - normalised (c)	(2.8)	(2.2)	(1.7)	(1.1)	(0.8)
EPS - normalised fully diluted (c)	(2.8)	(2.2)	(1.7)	(1.1)	(0.8)
EPS - (IFRS) (c)	(2.8)	(1.8)	(1.5)	(1.2)	(0.8)
Dividend per share (c)	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	16,581	16,502	16,615	16,779	16,762
Intangible Assets	16,347	16,305	16,455	16,659	16,659
Tangible Assets	175	134	109	69	52
Investments	60	63	51	51	51
Current Assets	2,580	5,203	2,383	2,764	6,219
Stocks	0	0	0	0	0
Debtors	67	134	149	212	212
Cash	2,227	4,705	2,015	2,392	5,847
Other	286	364	219	160	160
Current Liabilities	(1,736)	(1,437)	(1,791)	(4,861)	(4,861)
Creditors	(1,736)	(1,437)	(1,791)	(4,861)	(4,861)
Short term borrowings	0	0	0	0	0
Long Term Liabilities	0	0	0	0	(1,362)
Long term borrowings	0	0	0	0	(1,362)
Other long term liabilities	0	0	0	0	0
Net Assets	17,425	20,268	17,207	14,682	16,758
CASH FLOW					
Operating Cash Flow	(7,483)	(7,515)	(6,255)	(5,364)	(5,468)
Net Interest	23	28	41	59	62
Tax	0	0	0	0	0
Capex	(1,434)	(507)	(190)	(204)	0*
Acquisitions/disposals	0	0	0	0	0
Equity financing and convertible debt	6,952	10,842	4,951	5,864	7,500**
Dividends	0	0	0	0	0
Other	83	(384)	(1,237)	(83)	0
Net Cash Flow	(1,859)	2,464	(2,690)	272	2,094
Opening net debt/(cash)	(4,405)	(2,241)	(4,705)	(2,015)	(2,392)
HP finance leases initiated	0	0	0	0	0
Other	(305)	0	0	0	0
Closing net debt/(cash)	(2,241)	(4,705)	(2,015)	(2,287)	(4,486)

Source: Company accounts, Edison Investment Research. Note: *Nigeria net well costs to be funded by bridge finance, equity or farm-down. **Assumes exercise of in-the-money warrants expiring in July 2017. 2013 audited IFRS financials have been converted from reported currency of C$ to US$ at an average annual FX rate of US$0.934/C$. 2014 financials are for comparative purposes only and are as provided by the company in the 2015 financial report, which reflects the change in accounting policy resulting from a change in currency presentation to US$. 2015 financials are IFRS audited US$ accounts. With effect from 1 January 2015, the functional currency was changed from Canadian dollars to US dollars.

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand