Fastnet Oil & Gas

Building Moroccan momentum once again

CPR publication

Oil & gas

Fastnet has made another important step ahead of 2014 drilling with CPR confirmation of contingent and prospective resources at Tendrara as well as desktop studies confirming both a robust drill plan and potential development scheme. Meanwhile, the Foum Assaka farm-out process is close to completion (due in December), with Fastnet looking to beat the impressive Kosmos/BP deal secured recently. Both Moroccan targets are set to be drilled in H114, subject to rig deals, while Celtic Sea drilling is now likely to be a 2015 activity, subject to farm-out. The ball is already running in Morocco, with Cairn expecting to hit TD at Foum Draa in late December, with 10+ wells planned to drill over the next 12 months.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	Debt (£m)	Net cash/ (debt) (£m)	Capex (£m)
03/12	N/A	N/A	N/A	0.0	0.6	N/A
03/13	0.0	(2.3)	(2.1)	0.0	20.7	(2.3)
03/14e	0.0	(1.6)	(1.9)	0.0	19.2	0.0
03/15e	0.0	(1.9)	(12.6)	(21.9)	(21.9)	(38.7)

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

Tendrara CPR moves drilling closer

Three separate desktop studies have supported a CPR confirming 311bcf (116bcf net) of contingent resources at Tendrara with TE-5/Lakbir shaping up to be the preferred drill target in late H114. The success criteria for a fully funded appraisal well is well defined (sustainable rates need to be above 4mmscf/d) while 1,346bcf of prospective resources offer plenty of running room in the success case.

Foum Assaka farm-out terms eagerly anticipated

Fastnet's partner, Kosmos, recently secured a farm-out with BP for Foum Assaka, which matches the best terms secured offshore Morocco. Fastnet is in the process of closing its own farm-out process for Foum Assaka, which we expect to conclude in early December, with drilling of the first target (the 360mmboe Eagle-1 well) set to spud in Q114, subject to rig availability. Meanwhile, investor interest in offshore Morocco will surely grow as a multi-well drilling campaign is progressed, with Cairn's Foum Draa target the first to report, probably in late December 2013.

Valuation: Awaiting farm-out terms

Based on Kosmos/BP farm-out terms, our valuation currently sits at 40.5p per share, although we would expect this to increase if Fastnet can secure more attractive terms, which would not be altogether surprising. On a bottom-up DCF basis (although not adjusted for either running room or potential dilution), our RENAV sits at 50.4p, having been adjusted for both Tendrara and Eagle-1 resource estimates. Either way, there is clear potential for Fastnet to make gains in the coming months, from both its own newsflow and neighbouring drill activity offshore Morocco. In contrast with Morocco, Celtic Sea activities have been slower than expected, with drilling now likely in 2015, subject to farm-out discussions that we expect to firm up in the coming months.

19 November 2013

Price	**16.1p**
Market cap	**£44m**
	US$1.6/£
Net cash (£m) end Mar '13	20.7
Shares in issue	273.9m
Free float	90%
Code	FAST
Primary exchange	AIM
Secondary exchange	ESM

Share price performance

%	1m	3m	12m
Abs	(13.4)	(17.3)	(43.7)
Rel (local)	(14.5)	(20.1)	(53.8)
52-week high/low		28.5p	15.9p

Business description

Fastnet Oil & Gas is an E&P company focused on Morocco and offshore Ireland. The company differentiates itself from peers by following an aggressive deal flow-driven strategy with an objective to return all future gains to shareholders.

Next events

Foum Assaka farm-out	December 2013
Foum Draa TD	December 2013
Tendrara/Foum Assaka rig announcements	Q114
Foum Assaka drilling	Q114

Analysts

Ian McLelland +44 (0)20 3077 5756

Elaine Reynolds +44 (0)20 3077 5713

Will Forbes +44 (0)20 3077 5749

oilandgas@edisongroup.com

Edison profile page

Building Moroccan activity following a summer hiatus

After a relatively quiet summer period, newsflow has been coming in thick and fast again as Fastnet gears up for drilling both offshore and onshore Morocco in 2014. The company has taken a major step forward onshore Morocco at Tendrara after both desktop studies and a third-party CPR confirmed the potential to drill an exploration/appraisal well around the end of H114. Offshore Morocco, Fastnet's farm-out process is nearing conclusion with the recent Kosmos/BP deal pointing to the potential for record-breaking terms being secured ahead of drilling of the first target in Q114 with the 360mmboe gross Eagle-1 well. On balance, progress in the Celtic Sea has been slower than expected, although with two key sets of 3D seismic set to be delivered in November/early December, we expect to see progress here in the coming months.

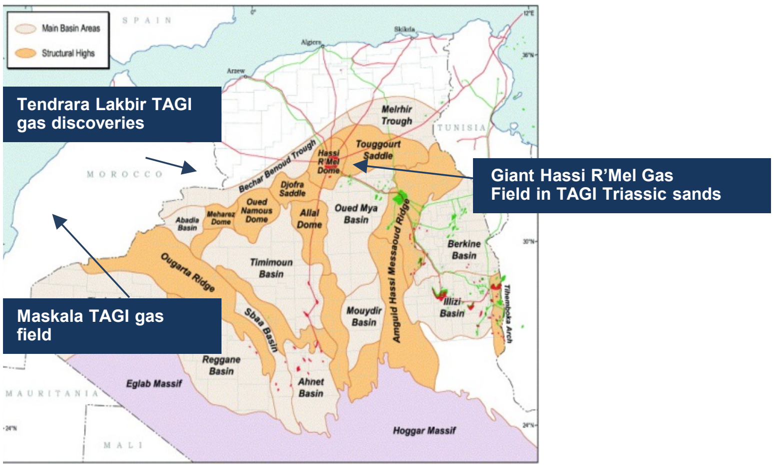
Tendrara: CPR moves drilling closer

Tendrara-Lakbir lies in the Missour Basin, where a working petroleum system has already been de-risked through two gas discoveries. The licence comprises eight exploration permits onshore Morocco covering an area of 14,528 km^2, making it the largest block in Morocco containing discovered gas. However, ahead of committing to the licence option and potential drilling in 2014, Fastnet needed to assure itself and investors of the resource potential of the block, to ascertain whether previously encountered drilling problems could be successfully addressed and explore the potential options for monetising any successful drilling programme. The results of all three of these studies were released simultaneously by the company on 12 November, paving the way for expected drilling now in H114.

Exhibit 1: Tendrara licence location

Source: Fastnet Oil & Gas

Exhibit 2: Morocco/Algeria geological map



Source: Fastnet Oil & Gas

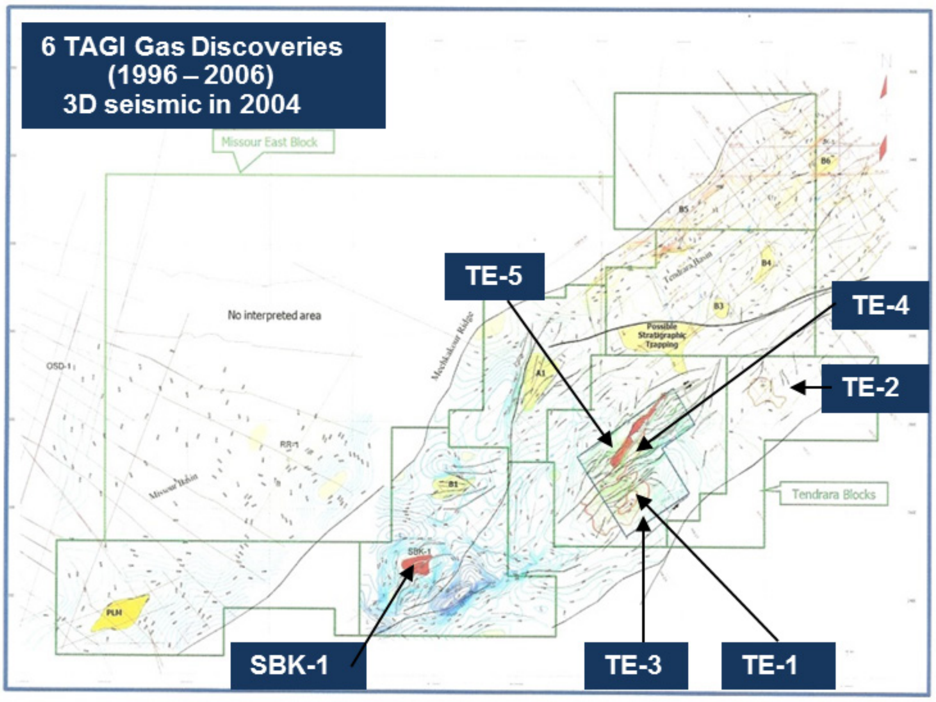
The target reservoirs at Tendrara are designated Triassic Argilo-Gréseux Inférieur (TAGI) and are a continuation of the Triassic sequences in Algeria that form the Hassi R'Mel gas field to the east, along with the oil fields of the SW Berkine Basin and the Maskala gas field in Morocco to the west (Exhibit 2). Six discoveries have been made from six wells to date at Tendrara, all in the TAGI reservoir, although results have been mixed. The key wells to focus on are TE-5 and SBK-1 (Exhibit 3).

- TE-5 flowed only at 1.4mmscf/d due to formation damage during drilling. However, with no pressure depletion during long-term testing (c three months), Fastnet is encouraged that there is good pressure support within the reservoir.

- SBK-1 flowed initially at 5mmscf/d, but rapidly depleted. The explanation for this is it is thought that the well was drilled adjacent to a fault creating a localised permeability barrier.

What is clear from history is that the challenges to quantifying, appraising and potentially developing Tendrara are not insignificant. Seismic availability is mixed with 4,110km of 2D acquired over 1974 to 1986 (950km of this was reprocessed in 2002) and 488km^2 of 3D acquired over the TE-5 target in 2004. However, data quality historically has been poor and Fastnet is only now reprocessing packets of this data to optimise well location decisions in 2014. Despite this, the company has been able to put together a package of desktop studies that, in our opinion, has moved Tendrara significantly forward in terms of drill readiness. These include a study by NuTech that has quantified properties for the TAGI reservoir consistent with good potential gas flow rates, and a design study by Summit Upstream that supports enhanced well potential by designing and drilling a conventional appraisal well using modern techniques to minimise formation damage.

Exhibit 3: Tendrara well locations



Source: Fastnet Oil & Gas

Based on the desktop exercises and using available seismic and well data (although not the seismic currently being reprocessed by Fastnet for well location optimisation), independent consultant, SLR, has been able to quantify new contingent and prospective resource estimates for the block. In the words of SLR from its CPR, only "a small area around the TE-5 well can be considered as 'contingent resources' based on the current well data", although this has still resulted in 310.5bcf gross (116.4bcf net to Fastnet) being classified as contingent. This is very close to our previous assumption of 334bcf (based on company guidance around production rates and licence period), although condensate estimates are now significantly down on previous estimates at only 0.86mmbbls gross.

One important observation about the planned Tendrara appraisal well is its relatively binary potential outcomes. Geological uncertainties are well understood with reservoir quality/permeability the main concern in an overall geological probability of success (GPoS) of 22%. This means that the focus is very much on whether Fastnet can design a well that will flow at commercial rates. The company has indicated that rates of 4-7mmscf/d would denote a success and pave the way for further drilling and field development.

With Morocco being a net importer of gas, Tendrara is strategic to the country's plans to be more energy balanced. Fastnet's partner at Tendrara, OGIF, is a Moroccan investment exploration company owned by a number of the country's largest financial institutions. The state has plans to construct a 400MW power plant that could be built on the Tendrara block and forms the basis for our modelling of the TE-5 development. Meanwhile, any excess gas could be directed to the Maghreb-Europe gas pipeline, in which Moroccan has unused capacity rights.

While we expect that the 311bcf of contingent resource booked against TE-5 already represents a likely commercial development in the success case, Fastnet has also indicated potential upside to these numbers based on the desktop studies. In particular, petrophysical studies show there is no gas-water contact in the TE-5 well, while new seismic depth mapping has shown that the formerly designated TE-5, Lakbir and TE-NE structures may be potentially a single structure with a common gas/water contact. However, we advise caution, as such a theory can only be tested with a long step-out appraisal well, which we would expect to be drilled only if the planned H114 appraisal well is successful.

In addition to the TE-5 contingent resources, SLR has proposed 1,345bcf gross (505bcf net to Fastnet) of prospective resources from five further structures across the Tendrara block, giving Fastnet (or any following party) significant running room for further exploration and appraisal activity in the event of success (Exhibit 4).

Exhibit 4: SLR resource estimates

	Gross			Net Attributable		
	Low estimate	Best estimate	High estimate	Low estimate	Best estimate	High estimate
Gas contingent resources (bcf)						
TE-5/ Lakbir structure	30.1	**310.5**	891.9	11.3	**116.4**	334.5
Oil contingent resources (mmbbl)						
TE-5/ Lakbir structure	0.72	0.86	7.64	0.27	0.32	2.87
Gas prospective resources (bcf)						
Belgrinate structure	45.7	212.2	806.6	17.1	79.6	302.5
Rass structure	76.2	353.6	1290.5	28.6	132.6	484
SBK structure	62	205	982.5	23.2	76.9	368.4
TE-4 structure	92.1	262.5	513.3	34.5	98.4	192.5
TE-1 structure	87.8	312.6	690.5	32.9	117.2	259
Prospective resource total	363.7	1345.8	4283.5	136.4	504.7	1606.3

Source: SLR, Fastnet Oil & Gas

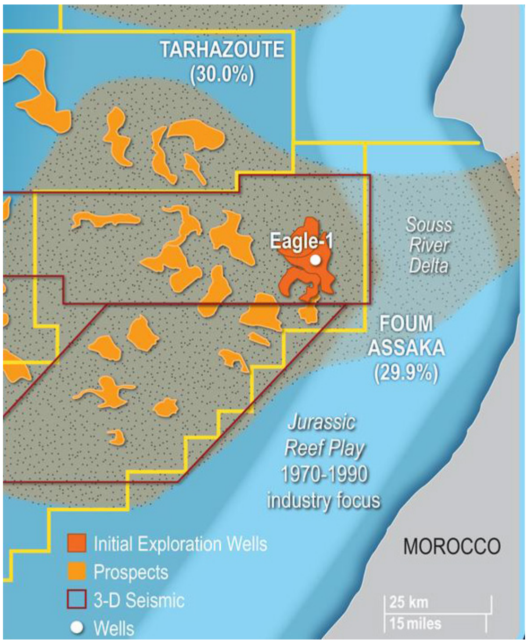
Foum Assaka: Q1 drilling; BP deal confirms value potential

While Tendrara drilling is looking to be a Q214 activity, we expect Fastnet to be ready to begin drilling offshore at Foum Assaka ahead of this. The company is finalising a farm-out process for its 25% gross (18.75% net) interest, while near-record terms for a recent farm-out deal between partner and operator, Kosmos Energy, and BP has underlined the value potential of the block.

Kosmos announced in mid-November that it expects to start drilling its first well at Foum Assaka in Q114, targeting the 360mmboe gross Pmean Eagle prospect in the north-east corner of the block (Exhibit 5). This is the first announcement covering the Foum Assaka block that confirms both a specific drill target and resource estimate and once again represents a major step forward for Fastnet's aspirations offshore Morocco.

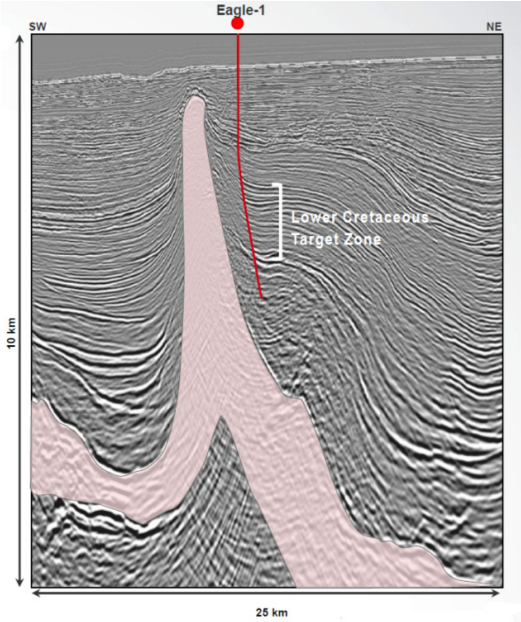
Eagle-1 is a large salt-cored structure with significant resource potential. The block partners are targeting the lower cretaceous zone that is bounded by a large moveable salt dome as shown in Exhibit 6. Of particular note is the sheer scale of the prospect (the seismic line covers 25km by 10km in depth), which means there is likely to be significant upside potential in the success case. Kosmos has still to confirm a rig to drill Eagle-1, but is guiding the market to a spud date in Q114.

Exhibit 5: Eagle-1 location



Source: Kosmos Energy

Exhibit 6: Eagle-1 seismic line



Source: Kosmos Energy

In addition to firming up its first drill target, Fastnet is also close to concluding a farm-out process for its interest in Foum Assaka, with the most recent announcement on 14 November that the company has now selected a preferred bidder and entered into an exclusivity agreement to complete the deal.

The Fastnet farm-out comes on the heels of partner Kosmos's October farm-out of its interest in three offshore Morocco block, including Foum Assaka, to major industry player, BP. On an acreage basis, this deal matches the terms achieved by Pura Vida in its Mazagan block farm-out with Plains E&P and confirms our expectation that Foum Assaka is one of the most prized blocks offshore Morocco (Exhibit 7).

Exhibit 7: Offshore Morocco farm-out deal valuation metrics

Date	Farming out	Farming in	Block	Acreage (km^2)	Back costs/ consideration (net)	Carry (gross)	No. wells	Gross interest farming out	Implied value ($m)	Implied value $/km^2
Nov-11	Fastnet	Kosmos	Foum Assaka	6,473	0	16.2	0	25%	64.8	10,011
Aug-12	San Leon*	Cairn	Foum Draa	3,350	1.5	60	1	50%	123.0	36,719
Aug-12	San Leon*	Genel	Sidi Moussa	5,018	1.3	50	1	60%	85.5	17,039
Dec-12	Tangiers	Galp	Tarfaya Offshore	7,244	7.5	33.5	1	50%	82.0	11,319
Jan-13	Pura Vida	Plains	Mazagan	10,897	15	215	2	52%	442.3	40,588
Oct-13	Kosmos	BP	Foum Assaka	6,473	15	75	1	35%	256.4	39,612
Oct-13	Kosmos	BP	Essaouira	11,731	0	100	1	60%	166.7	14,208
Oct-13	Kosmos	BP	Tarhazoute	7,754	0	100	1	60%	166.7	21,496

Source: Edison Investment Research

We expect Fastnet to spend the next three to four weeks completing binding legal agreements to complete the farm-out agreement (FOA). At present the terms remain confidential, but we would not be surprised if the company was able to match or possibly even beat the terms achieved by Kosmos, especially given Fastnet is running its own dedicated farm-out process rather than running a joint process with Kosmos (which made less sense given Kosmos was farming out three very different types of acreage).

In the meantime, interest in Morocco is likely to remain high with 10+ offshore wells planned to be drilled over the next 12-18 months. Cairn Energy spudded the first offshore well of the campaign in late October, targeting the F prospect on the Foum Draa block. The well is expected to reach TD in approximately 60 days. Foum Draa is similar to Foum Assaka in that it is a Cretaceous deepwater turbidite play, although in this case the source rock is older than at Foum Assaka.

Celtic Sea: Still awaiting news on farm-out

We continue to await news on the ongoing farm-out process relating to Fastnet's Celtic Sea assets. This has been delayed as industry enthusiasm for the region, driven by Providence/Lansdowne's Barryroe proposed development, has somewhat died down in recent months. However, Fastnet is driving its farm-out based on an exploration-led strategy focusing on its new, recently acquired 3D seismic. The focus is likely to be on two plays: Deep Kinsale, where the 3D is expected to be available in mid-November, and Mizzen, where seismic is expected in early December. It remains to be seen whether a deal can be completed in 2013.

Valuation: Awaiting farm-out terms

Pending confirmation of farm-out terms, especially for Foum Assaka, our valuation remains somewhat speculative at this time. However, we are able to update our models for the latest SLR estimates for Tendrara TE-5/ Lakbir contingent resources, Eagle-1 resource estimates and the Kosmos/BP farm-out terms.

Fundamental DCF economics

Based on 80$/bbl Brent and a 12.5% discount rate, our RENAV moves from 54.4p to 50.4p per share, mainly reflecting a reduction in condensate estimates for the Tendrara TE-5/ Lakbir structure offset by an increase in Eagle-1 resource estimates. However, we continue to stress that this is an undiluted number and hence can only be viewed as a value a potential acquirer could place on the company given its planned 2014 and 2015 drill activities. At the same time, this approach cannot take into consideration the extensive running room that Fastnet could enjoy across its portfolio in the event of exploration success. In addition to Foum Assaka and the Celtic Sea, this now includes the potential for up to five follow-up targets at Tendrara in the success case, as shown previously in Exhibit 4.

Exhibit 8: Fastnet undiluted DCF valuation – how an acquirer would look at the company

Asset				Recoverable reserves			Net risked	Value per share	
	Country	Diluted WI	CoS	Gross	Net	NPV/boe	value	Risked	Unrisked
		%	%	mboe	mboe	$/boe	$m	p/share	p/share
Net (Debt) Cash		100%	100%				32.1	7.6	7.6
SG&A		100%	100%				-2.3	-0.5	-0.5
Production + Cash					0.0		29.8	7.0	7.0
Development									
Tendrara TE-5/Lakbir	Morocco	38%	22%	53.3	20.0	7.5	32.9	7.8	35.2
Development					20.0		32.9	7.8	35.2
Cash + Production + Development					20.0		62.7	14.8	42.3
Exploration (2014 + 2015)									
Foum Assaka Eagle-1	Morocco	19%	13%	360.0	67.5	8.0	71.7	16.9	127.4
Deep Kinsale	Ireland	50%	15%	220.0	110.0	4.8	79.7	18.8	125.2
Exploration NAV (2014 + 2015)					177.5		151.4	35.7	252.6
RENAV							**214.2**	**50.4**	**294.9**

Source: Edison Investment Research

Farm-out economics

Fastnet still needs to farm down interests in Foum Assaka and the Celtic Sea ahead of drilling, hence we still prefer to use potential farm-out terms as a more accurate guide of valuation in the near term. Based on the same assumptions as our July initiation note, but updating for Tendrara volumes, we arrive at a sensitivity range of 35-57p per share, centred around 40.5p per share (previously 41.2p) based on the Kosmos/BP farm-out terms for Foum Assaka.

Exhibit 9: Valuation based on farm-out scenarios

	Foum Assaka farm-in block value ($k/km^2)			
Celtic Sea share to give up	**30**	**40**	**50**	**60**
50%	34.9	38.8	42.6	46.4
40%	36.7	40.5	44.3	48.1
30%	39.7	43.5	47.3	51.1
20%	45.6	49.4	53.2	57.0

Source: Edison Investment Research

As previously indicated, we recognise that equity markets continue to discount E&P players heavily in comparison with the terms achieved from industry. However, with major interest in Morocco likely to continue during 2014, we see plenty of running room in the share price ahead of drilling.

Financials: Fully funded subject to FOA

We update our financials for FY13 results and include nominal forecasts for year ending March 2015. This shows a net cash deficit of £22m in FY15 based on drilling both Foum Assaka and Tendrara within the financial year. £18m of this is associated with Foum Assaka, hence if Fastnet can secure an FOA that pays back costs and at least one well carry, it will provide sufficient funds to complete the 2014/15 work programme. This does not include any provision for payment of back costs associated with the Celtic Sea assets that could further bolster cash reserves.

Exhibit 10: Financial summary

£'000s	2012	2013	2014e	2015e
March	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	N/A	0	0	0
Cost of Sales	N/A	0	0	0
Gross Profit	N/A	0	0	0
EBITDA	N/A	(2,307)	(1,579)	(1,911)
Operating Profit (before amort. and except.)	N/A	(2,310)	(1,579)	(11,649)
Intangible Amortisation	N/A	0	0	0
Exceptionals	N/A	0	0	0
Other	N/A	706	0	0
Operating Profit	N/A	(1,604)	(1,579)	(11,649)
Net Interest	N/A	210	(276)	(934)
Profit Before Tax (norm)	N/A	(2,100)	(1,855)	(12,583)
Profit Before Tax (FRS 3)	N/A	(1,394)	(1,855)	(12,583)
Tax	N/A	0	0	0
Profit After Tax (norm)	N/A	(1,394)	(1,855)	(12,583)
Profit After Tax (FRS 3)	N/A	(1,394)	(1,855)	(12,583)
Average Number of Shares Outstanding (m)	55	194	274	274
EPS - normalised (c)	0.0	(0.7)	(0.7)	(4.6)
EPS - normalised fully diluted (c)	0.0	(0.7)	(0.7)	(4.6)
EPS - (IFRS) (c)	0.0	(0.7)	(0.7)	(4.6)
Dividend per share (p)	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A
BALANCE SHEET				
Fixed Assets	1	7,925	7,925	36,896
Intangible Assets	0	7,917	21,917	45,143
Tangible Assets	1	8	(13,992)	(8,247)
Investments	0	0	0	0
Current Assets	731	20,809	19,322	73
Stocks	0	0	0	0
Debtors	85	73	73	73
Cash	646	20,736	19,249	0
Other	0	0	0	0
Current Liabilities	(95)	(443)	(443)	(443)
Creditors	(95)	(443)	(443)	(443)
Short term borrowings	0	0	0	0
Long Term Liabilities	0	(111)	(111)	(21,970)
Long term borrowings	0	0	0	(21,859)
Other long term liabilities	0	(111)	(111)	(111)
Net Assets	637	28,180	26,693	14,556
CASH FLOW				
Operating Cash Flow	N/A	(708)	(1,487)	(2,399)
Net Interest	N/A	0	0	0
Tax	N/A	0	0	0
Capex	N/A	(2,322)	0	(38,710)
Acquisitions/disposals	N/A	0	0	0
Financing	N/A	23,092	0	0
Dividends	N/A	0	0	0
Net Cash Flow	N/A	20,062	(1,487)	(41,109)
Opening net debt/(cash)	N/A	(646)	(20,736)	(19,249)
HP finance leases initiated	N/A	0	0	0
Other	N/A	28	(0)	0
Closing net debt/(cash)	N/A	(20,736)	(19,249)	21,859

Source: Company accounts, Edison Investment Research