EDISON

Canadian Overseas Petroleum

Market update

Liberia on autopilot, Nigeria the next step

Oil & gas

2014 looks set to be a definitive year for Canadian Overseas Petroleum (COPL) with exploratory drilling on the company's key Liberian block LB-13 due to commence post July. With its share of exploration drilling costs in Liberia fully carried by ExxonMobil, COPL continues to evaluate asset deals in Nigeria as the future direction for the company, execution of which may give rise to further future funding requirements.

Year end	Revenue (C$m)	EBITDA (C$m)	PBT* (C$m)	Net cash/(debt) (C$m)	Capex (C$m)
12/11	0.0	(54.3)	(53.8)	71.9	(35.3)
12/12	0.0	(56.6)	(56.6)	4.4	(0.4)
12/13	0.0	(9.8)	(9.9)	2.4	(1.5)
12/14e	0.0	(8.3)	(8.3)	(1.7)	0.0

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

LSE listing and fund-raise

In April 2014 COPL successfully obtained a secondary listing on the main market of the London Stock Exchange. At the same time, the group raised £2.4m (gross) of additional capital through a placement of shares. We estimate this leaves the company funded through at least the next six months. Execution of deals in Nigeria is likely to give rise to further funding needs.

Newsflow from Liberia hotting up by mid-year

In what remains the core of COPL's portfolio, the group retains a 'free-carried' 17% interest in the highly prized block LB-13 offshore Liberia. We expect newsflow from this asset by mid-year with the first of COPL's two-well programme expected to spud post July. Around the same time, we expect some form of announcement from Chevron's four-well exploration programme in neighbouring blocks LB-11/LB-12 and LB-14. Results from these wells will have a material impact on COPL.

Nigeria; assessing its options

COPL's strategy is to grow in West Africa with a specific focus on offshore Nigeria. Despite sources of funding remaining unclear, this strategy holds considerable merit in our view. As a proven oil province with a favourable tax regime, Nigeria could significantly reduce the risk profile and consolidated nature of the group's assets.

Valuation: Liberia dominates

Our valuation of COPL focuses on the modelling of the two Liberian prospects targeted for drilling in partnership with ExxonMobil later this year. Based on DCF analysis of these prospects and subsequent 'geological risking', we arrive at a suggested RENAV for COPL of $0.36/share. We stress that COPL's ultimate value remains almost solely dependent on the outcome of its Liberian exploration, up to $1.60/share assuming success, down to $0.11/share in the event of failure.

6 May 2014

Price	**C$0.28**
Market cap	**C$98m**
	C$1.03/US$
Net cash as at 31 Dec 2013	C$2.38m
Shares in issue	351m
Free float	99%
Codes	XOP/COPL
Primary exchange	TSX-V
Secondary exchange	LSE

Share price performance

%	1m	3m	12m
Abs	(5.1)	0.0	55.6
Rel (local)	(7.1)	(7.7)	31.7
52-week high/low		C$0.4	C$0.2

Business description

Canadian Overseas Petroleum is an Africa-focused E&P with exploration assets in Liberia and plans to expand through acquisition in Nigeria. ExxonMobil is its operator and farm-in partner in Liberia Block LB-13.

Next events

Liberia well spud	H214

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LSE listing and fund-raise maintain momentum

COPL obtained a secondary listing on the main market of the London Stock Exchange, effective April 2014. At the same time, the group raised £2.4m (gross) of additional capital aimed at covering near-term working capital commitments and specific due diligence costs related to the assessment of new deals in Nigeria.

COPL's end-2013 cash stood at $2.4m, and assuming its average monthly spend from that date is maintained, the capital raised is likely to see the company's working capital commitments covered for at least a further six months.

While COPL's share of current drilling commitments in Liberia is carried by Exxonmobil, the group's targeted entry into Nigeria is likely to require additional, and potentially creative, sources of funding. COPL's favoured Nigerian prospect (an 'earn-in' for 40% of 'OPL 2010') is estimated to require an initial $18.5m in funding ($3.5m option cost plus $15m seismic costs) with a further $25m in drill costs falling due before the full 40% interest in OPL 2010 being earned by the company.

Liberia; material prospectivity and a carried interest

In COPL's core portfolio the group retains a 'free-carried' 17% working interest in the highly prized Block LB-13 offshore Liberia, the remaining 83% being held by block operator, ExxonMobil. On acquiring its 83% interest in LB-13 from COPL in 2013, ExxonMobil agreed to bear full costs of a two-well exploration programme on the licence, to a maximum spend for drilling purposes of $120m.

The first of these is expected to spud post July. An independent assessment of Block LB-13's potential carried out by Degoyler & McNaughton in May 2012 highlighted 13 prospects available to target with prospective total 2P resource potential of 450mmbbl net to COPL. Six of those are detailed in Exhibit 1; all demonstrate significant materiality on an individual basis.

Exhibit 1: LB-13 Liberia, material prospects

Prospects	Best estimate (mmbbl)	Geological chance of success (%)
Location A	343	21.2
Location B	225	19
Location C	213	12.7
Fali Lobe	309	23
Fali Channel	698	22
Bene	592	28

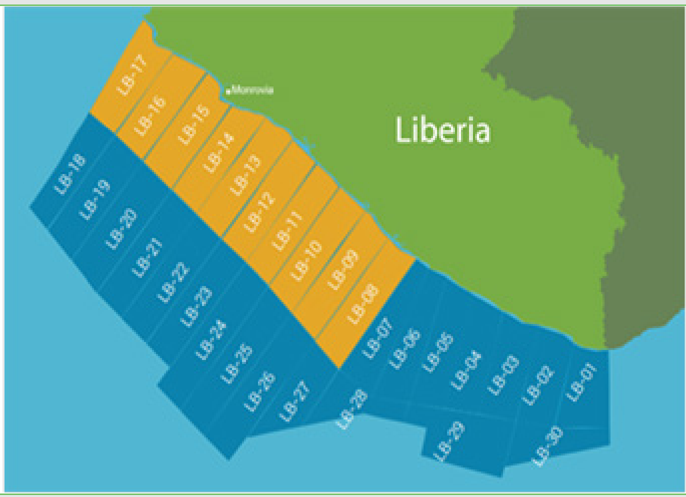
Source; Canadian Offshore Petroleum

Neighbouring activity likely to have an impact

Given the early stage nature of COPL's exploration in Liberia, news and analysis of neighbouring activity in the region or 'closology' is of material impact to COPL shares.

The size and relative location of Liberia's continental shelf blocks is illustrated overleaf in Exhibit 2; as can be seen, only comparatively shallower blocks LB-08 to LB-17 are currently under licence, with blocks LB-01-LB07 and ultra-deep-water blocks LB-18-LB-30 remaining open.

Exhibit 2 Liberian offshore acreage, open blocks in blue



Source: National Oil Company of Liberia (NOCAL)

There are two main consortiums either side of COPL-ExxonMobil in Block LB-13, which hold acreage and are actively exploring for oil; firstly, the Chevron-led consortium, with blocks 11, 12 and 14 directly adjacent and to the south of LB-13; and secondly the Anadarko-led consortium in blocks 15, 16 and 17 directly to the north of LB-13. The specific equity interest for consortium members in each of these blocks is shown in Exhibit 3 below.

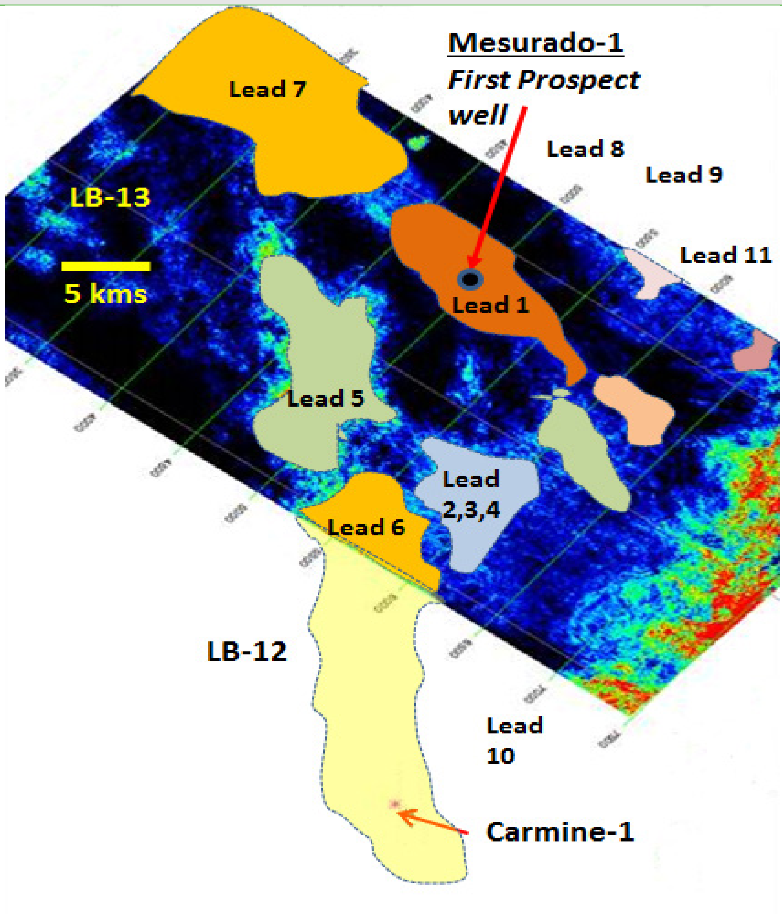
Exhibit 3: Licence interests, Liberia continental shelf

	LB-08 & LB-09	LB-10	LB-13	LB-11/LB-12 & LB-14	LB-15	LB-16 & LB-17
African Petroleum	100%					
Repsol		10%			27.5%	75%
Tullow Oil					25%	25%
ExxonMobil			83%			
Canadian Offshore Petroleum			17%			
Anadarko		80%			47.5%	
Mitsubishi		10%				
Chevron				45%		
Oranto				30%		
Eni				25%		
	100%	**100%**	**100%**	**100%**	**100%**	**100%**

Source; National Oil Company of Liberia (NOCAL)

Of the two groups, the Chevron-led consortium has shown the greatest commitment to the region. Since 2010 Chevron has spent over $10m on health and education programmes, opened a company office in Monrovia and established an onshore supply base to support its activities offshore. The results from Chevron's initial two-well exploration programme, completed in 2012, are yet to be disclosed. Of these two wells, the outcome of Carmine-1 in Block LB-12 will be of greatest materiality to COPL since it targeted a structure thought to extend across Chevron's LB-12 boundary and into LB-13 as shown overleaf in Exhibit 4.

Exhibit 4: Liberia Block LB-13 prospectivity



Source: Canadian Offshore Petroleum

As a potential indication of undisclosed success to date, Chevron has embarked on a further two-well exploration programme in Liberia, which we believe consists of an appraisal well at Carmine in LB-12 and an exploration well at LB-14. Both wells are expected to take around 45 days to drill. The first well has reportedly spudded, hence some form of announcement is expected at Chevron's mid-year results presentation in July.

Mid-year 2014 is likely to be a period of significant newsflow for COPL, since on completion of the Chevron wells the Seadrill rig could move on to location at LB-13 to test the two prospects mutually agreed by ExxonMobil and COPL.

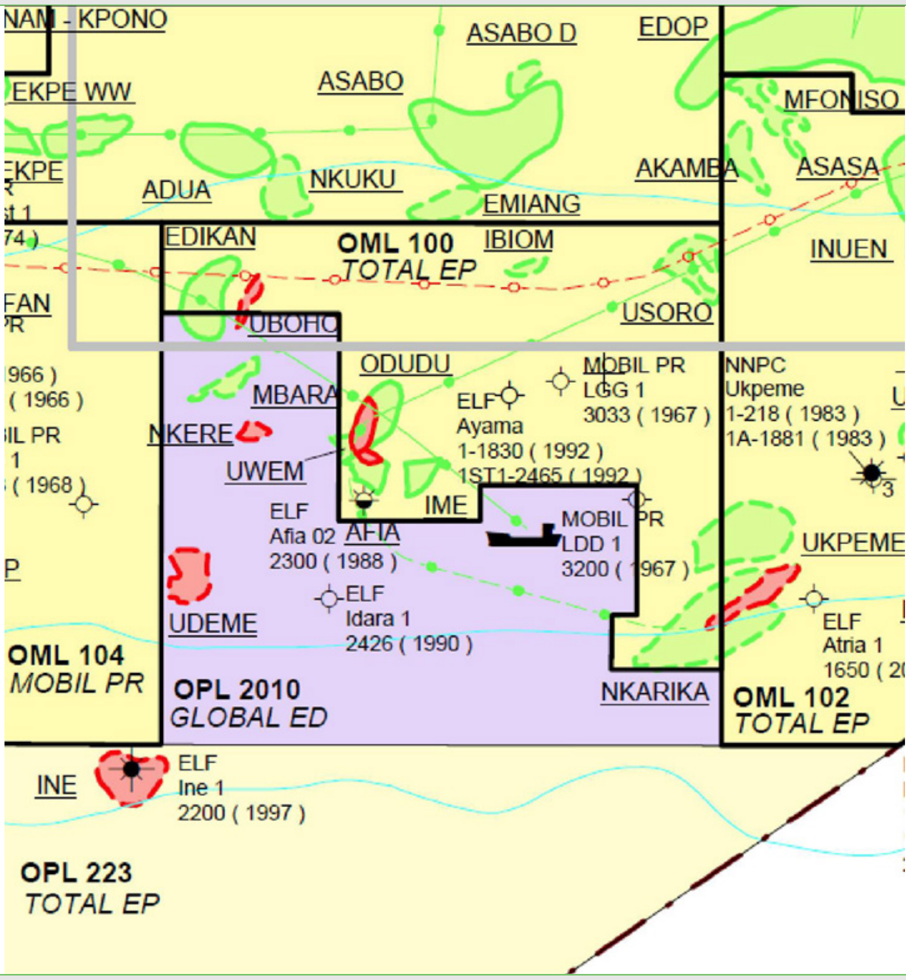
Nigeria; assessing options

COPL is increasingly focused on offshore Nigeria as an area of specific interest and opportunity for the group. In terms of due diligence, the group has allocated significant resources to assessing deals in the region and by way of success has been pre-selected as technical partner to four companies with domestic interests.

This strategy holds merit in our view; as a proven oil province with a favourable tax regime, Nigeria could significantly reduce the risk profile and consolidated nature of the group's assets.

Of the deals being assessed by COPL in Nigeria, the group highlights its non-binding agreement to earn in to OPL 2010 as a potential front runner, but also as typical of the types of deal available to the company in the region. Shown in Exhibit 5, OPL 2010 originally formed part of OPL 100 awarded to Elf Nigeria in the 1960s; the 50% of OPL 100 relinquished by Elf converted to OPL 2010.

Exhibit 5; Nigerian option, OPL 2010



Source: Canadian Offshore Petroleum

Under terms of a non-binding agreement with GEDC, in exchange for a $40m work commitment on OPL 2010 and a $5m two-stage option fee, COPL would earn a 40% interest in OPL 2010. Although no prospect size or potential have been disclosed by COPL, the block appears prospective, having hosted five wells from1982-92, four of which resulted in discoveries. One of these, Uwem-1, is tabled by COPL as having potential for re-entry, targeting a thicker reservoir section, subject to the 3D seismic survey forming the first phase of COPL's work commitment on the block.

Exploration programme continues in New Zealand

COPL continues to progress its activities in New Zealand, with exploration on the east coast at permit #53806 moving on to the second phase of exploration, acquisition of seismic. The company estimates costs associated with this phase at around £2.5m, although timing may depend on the phasing of funds used elsewhere, for example in Nigeria, which could push this commitment into 2015.

COPL first entered New Zealand in November 2012, with the award of unconventional resource permit #53806 situated on the east coast. In partnership with Marauder Resources (50%), COPL is targeting the exploitation of two shales, Waipawa and Whangai. According to Degoyler & McNaughton, total gross prospective 2P resources for the licences stand at 142mmbbl, implying 170-430,000bbl recoverable to COPL.

Valuation

Fundamental DCF economics point to RENAV of $0.36/share

Our DCF analysis implies a c $0.36/share risked NAV for COPL shares. However, we stress that this figure will be heavily influenced by the outcome of COPL's and its neighbours' exploration activity in Liberia this year. We suggest potential for up to C$1.60/share assuming success, falling to $0.11/share on failure.

Our financial model uses an illustrative 500mmbbl oil discovery in Liberian Block LB-13, with a further 250mmbbl discovered by side track of the initial well. We apply a real oil price assumption of $80/bbl to field production, with first oil production assumed by 2020. We apply a 12.5% discount rate to revenues from these fields as a reflection of Liberia's heightened country risk.

Exhibit 6: COPL DCF valuation

Asset				Recoverable reserves			Net risked	Value per share	
	Country	Diluted WI (%)	CoS (%)	Gross (mmboe)	Net (mmboe)	NPV/boe ($/boe)	Value ($m)	Risked (C$/share)	Unrisked (C$/share)
Net cash est. 30 April 2014e							3.85	0.01	0.01
SG&A							-4.80	-0.02	-0.02
Core NAV							-0.95	-0.01	-0.01
Exploration (2014)									
Block LB13	Liberia	17%	23%	499	85	4.3	81	0.25	1.13
Block LB13	Liberia	17%	23%	250	43	4.3	41	0.12	0.57
PEP 53806	New Zealand	0.5					0.43	0.001	0.001
RENAV							**115**	**0.36**	**1.69**

Source: Edison Investment Research

Financials; additional sources of funding required

At end December 2013, COPL's balance sheet showed net cash of $2.4m. In April 2014 COPL listed on LSE and raised $4.4m (gross). COPL's share of gross drilling costs for the two-well programme in 2014 is carried by ExxonMobil, leaving the key use of funds this year to be allocated to Nigeria and potentially the acquisition of seismic on New Zealand. We have assumed in our estimates that COPL continues its current level of expenditure, leading us to our end 2014 estimated net debt figure of $2m. Evaluating and activating the Nigerian option would give rise to further funding requirements. Depending on this, and taking into account that outlays in Nigeria are likely to take precedence over New Zealand, it seems sensible to assume that further funding will be required over the course of the next 12 months.

Exhibit 7: Financial summary

C$'000s	2008	2009	2010	2011	2012	2013	2014	2015e
December	UK GAAP	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	0	0	0	0	0	0	0	0
Cost of Sales	0	0	0	0	0	0	0	0
Gross Profit	0	0	0	0	0	0	0	0
EBITDA	0	0	(8,827)	(54,297)	(56,558)	(9,814)	(8,251)	(8,663)
Operating Profit (before amort. and except.)	0	0	(8,838)	(54,327)	(56,612)	(9,877)	(8,301)	(8,698)
Intangible Amortisation	0	0	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0	0	0
Other	0	0	(39)	346	(72)	780	0	0
Operating Profit	0	0	(8,877)	(53,981)	(56,684)	(9,097)	(8,301)	(8,698)
Net Interest	0	0	(444)	553	46	25	9	(57)
Profit Before Tax (norm)	0	0	(9,282)	(53,774)	(56,566)	(9,852)	(8,292)	(8,755)
Profit Before Tax (FRS 3)	0	0	(9,321)	(53,428)	(56,638)	(9,072)	(8,292)	(8,755)
Tax	0	0	0	0	0	0	0	0
Profit After Tax (norm)	0	0	(9,321)	(53,100)	(56,784)	(8,914)	(8,292)	(8,755)
Profit After Tax (FRS 3)	0	0	(9,321)	(53,428)	(56,638)	(9,072)	(8,292)	(8,755)
Average Number of Shares Outstanding (m)	0.0	0.0	29.3	257.3	284.0	301.9	351.5	351.5
EPS - normalised (C$cents)	0.0	0.0	(31.8)	(20.6)	(20.0)	(3.0)	(2.4)	(2.5)
EPS - normalised and fully diluted (C$cents)	0.0	0.0	(31.8)	(20.6)	(20.0)	(3.0)	(2.4)	(2.5)
EPS - (IFRS) (C$cents)	0.0	0.0	(31.8)	(20.8)	(19.9)	(3.0)	(2.4)	(2.5)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	0.0	0.0	N/A	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)	0.0	0.0	N/A	N/A	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	0.0	0.0	N/A	N/A	N/A	N/A	N/A	N/A
BALANCE SHEET								
Fixed Assets	0	0	102	36,119	15,191	17,753	17,703	68,668
Intangible Assets	0	0	0	20,594	0	17,502	17,502	68,502
Tangible Assets	0	0	59	227	218	187	137	102
Investments	0	0	43	15,298	14,973	64	64	64
Current Assets	0	0	37,478	72,533	4,823	2,762	3,820	(55,900)
Stocks	0	0	0	0	0	0	0	0
Debtors	0	0	83	446	237	72	72	72
Cash	0	0	37,373	71,924	4,374	2,384	3,442	(56,278)
Other	0	0	22	163	212	306	306	306
Current Liabilities	0	0	(989)	(35,048)	(3,194)	(1,859)	(1,859)	(1,859)
Creditors	0	0	(989)	(35,048)	(3,194)	(1,859)	(1,859)	(1,859)
Short term borrowings	0	0	0	0	0	0	0	0
Long Term Liabilities	0	0	0	0	0	0	(5,100)	(5,100)
Long term borrowings	0	0	0	0	0	0	(5,100)	(5,100)
Other long term liabilities	0	0	0	0	0	0	0	0
Net Assets	0	0	36,591	73,604	16,820	18,656	14,564	5,809
CASH FLOW								
Operating Cash Flow	0	0	(6,298)	(16,764)	(66,251)	(8,012)	(8,251)	(8,663)
Net Interest	0	0	(2)	593	57	25	9	(57)
Tax	0	0	0	0	0	0	0	0
Capex	0	0	0	(35,257)	(405)	(1,535)	0	(51,000)
Acquisitions/disposals	0	0	0	0	0	0	0	0
Equity financing and convertible debt	0	0	44,304	85,949	(951)	7,532	4,200	0
Dividends	0	0	0	0	0	0	0	0
Net Cash Flow	0	0	38,004	34,521	(67,550)	(1,990)	(4,042)	(59,721)
Opening net debt/(cash)	0	0	0	(37,373)	(71,924)	(4,374)	(2,384)	1,658
HP finance leases initiated	0	0	0	0	0	0	0	0
Other	0	0	(75,377)	30	0	0	0	0
Closing net debt/(cash)	0	0	37,373	(71,924)	(4,374)	(2,384)	1,658	61,378

Source: Canadian Overseas Petroleum accounts, Edison Investment Research

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