EDISON

TransGlobe Energy

EGPC receivables issue resolved

Market update

Oil & gas

TransGlobe Energy (TGA) has announced a raft of measures aimed at seeing it through the current weak oil price environment, reducing capital investment for 2015 and focusing on costs. From an operational perspective, the focus near term shifts from exploration drilling to high-grading the prospect inventory; processing of the group's large Egyptian 3D seismic survey is ongoing. The effective resolution of TGA's EGPC payment issue adds material strength to the balance sheet. Having received US$140m in cash payments from EGPC in the fourth quarter, TGA now holds c US$140m in cash at an opportunistic time to carry out deals.

Year end	Revenue (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	Capex (US$m)	Net (debt)/ cash (US$m)
12/13	315.7	143.9	79	0	(132)	35
12/14e	304.0	138.3	92	20	(106)	59
12/15e	156.6	(7.0)	(49)	20	(37)	118
12/16e	230.9	67.7	32	20	(19)	167

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

EGPC makes significant receivables reduction

TGA received several payments amounting to US$140.1m from EGPC in Q414, taking the total for payments received in 2014 to US$233.5m, reducing the receivables balance owed by EGPC to US$120m. On the basis of recent progress we expect this balance to be fully paid within the near-term. In addition, TGA has agreed a self-marketing agreement with EGPC, ensuring payments are received direct by the company going forward.

Focus in Egypt shifts from seismic to drilling

TGA has announced a reduced capital budget of US$37m for 2015, with just US$7m of this to be spent on drilling wells. Emphasis of operations in Egypt now shifts to high-grading of the prospect inventory, with gathering of seismic and interpretation operations ongoing. In addition to conserving cash flow, this strategy ensures the group has a commercial drilling inventory in preparation to restart investment in response to any stabilisation in the macro environment.

Valuation: EGPC payment partly offsets weak macro

Based on our DCF analysis we reduce our valuation for TGA from US$7.5/share to US$6.0/share (RENAV) reflecting the group's lower production estimates for 2014 and the weaker macro environment. In a sense check to this DCF valuation we assess the company's value on an absolute basis as at year-end 2014. Based on this analysis we see the shares as well supported with the group holding US$177.5m in net cash and receivables (US$2.4/share). Also, we see TGA as a solid value opportunity to those with a constructive view on long-term oil prices, trading at under 1x cash flow (0.84x) under our long-term US$80/bbl oil price scenario.

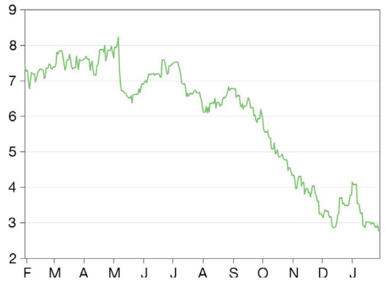
30 January 2015

Price **US$2.76**

Market cap **US$208m**

Net cash (US$m) at 30 Sept 2014 (includes convertible debentures)	5.3
Shares in issue	75.2m
Free float	72%
Code	TGA
Primary exchange	NASDAQ
Secondary exchange	TSX

Share price performance



%	1m	3m	12m
Abs	(24.5)	(39.3)	(63.3)
Rel (local)	(22.0)	(40.5)	(67.8)
52-week high/low		US$8.58	US$2.86

Business description

TransGlobe Energy (TGA) is an exploration and production company with producing assets in Egypt (16,000b/d) and Yemen (200b/d). In addition to significant production in Egypt, the group controls significant exploration acreage in the vicinity of existing facilities.

Next event

Full-year results March 2015

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Edison profile page

2015 guidance and corporate update

2015 corporate guidance, balance sheet preservation

On 9 January TGA gave a corporate update including updated guidance for 2015. A key theme of this announcement was the reduction in near-term capital investment and operating costs in response to the dramatic fall in crude oil prices. In addition, the group has lowered its estimates for 2015 production from Egypt, particularly West Gharib, due to ongoing pump reliability issues and reduced capital investment aimed at arresting naturally declining field production.

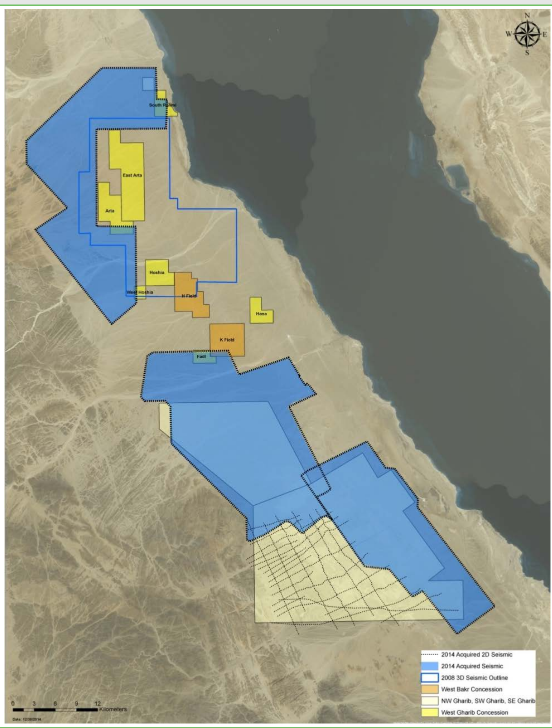
On the positive side, TGA announced a major advance in resolving its EGPC payment issue in receiving US$140m in cash in Q4 in addition to agreeing with EGPC to self-market its own crude in the future, removing the receivables issue going forward.

2015 drilling programme reduced in favour of seismic

For 2015, TGA has guided a reduced capital investment programme for the year at US$37m, which is based on TGA's realistic US$50/bbl oil price assumption for the first quarter. The US$37m is split US$19m for exploration and US$18m for development. Within the US$18m development spend only US$7m is allocated to the drilling of five new wells, with the remaining US$11m allotted to facilities. Within the US$19m exploration spend, US$17m is scheduled for seismic acquisition and processing, all within Egypt. In an effort to reduce ongoing drilling costs in Egypt, following completion of the five planned wells in Q115, all rigs operating on behalf of TGA in Egypt will be released, with the intention of re-contracting them at lower rates going forward.

As you would expect, given the prevailing low crude price environment, TGA's outlined work programme for 2015 favours the less capital intensive seismic processing and interpretation over drilling activity. On this basis, in Egypt TGA is focusing on its G&G work programme, aimed at working up new prospects in addition to high-grading the existing prospect inventory. As well as conserving cash flow, this strategy ensures the group has a commercial drilling inventory in preparation to restart investment in response to any stabilisation in the macro environment.

Exhibit 1: Egypt, Western desert seismic programme currently underway



Source: TransGlobe Energy

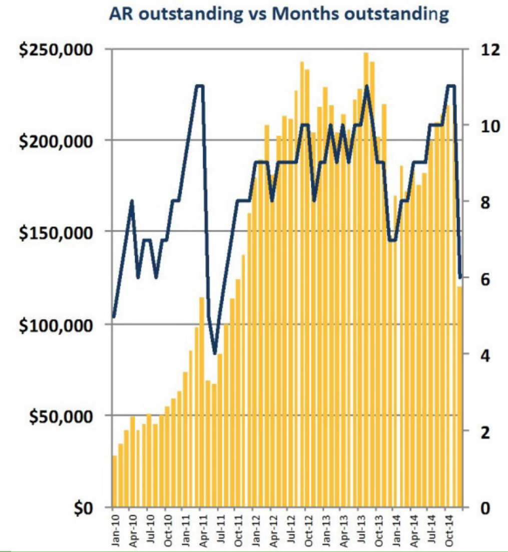
TGA's total seismic programme for 2014/15 consists of 1,000km^2 of 3D and 325km of 2D in the Eastern desert, and 400km^2 of 3D in the Western desert (shown in Exhibit 1). The Eastern desert programme was completed in December; this survey is in processing with interpretation and working-up of prospects expected to begin in Q215. In the Western desert the seismic programme is underway, with completion expected by May 2015.

TGA's combined Eastern and Western desert seismic programmes are extensive and should be commercially rewarding, given they focus on acreage proximal to existing discoveries and production. Hence, any discoveries should be quickly brought to market.

Material payments in Q414 cuts receivables by 50%

As we highlighted in our November TransGlobe initiation note *Egyptian focus, asset-backed plus growth*, we saw an improving political landscape in Egypt, with the fledgling government financially backed by well-funded Middle East nations and committed to repaying foreign oil company debt. At the point of our initiation note, EGPC's debt to TGA stood at c US$216.3m and as such represented a major question mark over TGA's valuation.

Exhibit 2: EGPC accounts receivable showing a material reduction in Q414



Source: TransGlobe Energy

In what has been a sharp turnaround of this issue, TGA received a material payment of US$140.1m from EGPC in Q414, taking the total for payments received in 2014 to US$233.5m. This US$140m payment comprised of one and a half cargo liftings in the fourth quarter in addition to a lump sum payment of US$50m received on 31 December. The significant progress on payments from EGPC leaves TGA's outstanding receivables balance at just US$120m. A further reduction in this US$120m is expected in the near term, with TGA receiving 'over lift' payments. This is where a tanker loading consisting of EGPC crude in addition to TransGlobe crude is sold; rather than pay EGPC their share, the money is retained by TGA and used to further reduce EGPC's $120m receivables balance.

Self-marketing agreement eliminates receivables issue going forward

As announced in its corporate update of 9 January, TGA now has an agreement in place with EGPC to self-market its own crude. This allows the group to directly negotiate crude shipments with international buyers, negating the risk that an oil sales receivables debt to TGA would regenerate. The first shipments under this agreement are scheduled for late January and April 2015.

Q115 cash flow affected by low oil prices

As previously mentioned, TGA has adopted a US$50/bbl Q115 oil price assumption for planning purposes. Under this scenario the group would generate positive cash flow of US$1m in the period; hence we assume US$50/bbl is roughly break-even level for these assets. In terms of cash flow sensitivity beyond US$50/bbl, TGA suggests that at US$60/bbl the group would generate an additional US$4.7m in cash flow. Hence, if the macro environment does improve into 2015, we would expect the group to increase capital investment from the increased cash flow generated.

Pump reliability continues to affect production

Driving the above cash flow forecast for the first quarter is TGA's new production guidance over the same period. The group suggests production will average 14mb/d in the first quarter of 2015, comprised of 13.8mb/d from Egypt and 200b/d from Yemen. This is lower than production in Q414 of 15,183b/d, which had been negatively affected by PCP pump reliability issues in Egypt. These pump issues remain ongoing at West Gharib (the group's main Egyptian producing licence) where replacement pumps are on-site and will be installed and optimised during 2015. According to management, TGA currently holds c 1mbbl/d of production behind pipe, thought to be the three discoveries made as part of the 2014 drilling programme, which are due to be tied-in in the short term. It seems sensible the group is not scrambling to replace pumps and increase output under the current macro environment.

Valuation: Reduction in receivables partly offsets weak macro

As shown in Exhibit 3, our valuation for TransGlobe is reduced from US$7.5/share to US$6.0/share, reflecting our weaker outlook for oil prices in 2015 and 2016. For 2015 and 2016 we reduce our crude price forecasts to US$52.5/bbl and US$72.5/bbl respectively. Longer term we retain our US$80/bbl forecast. In addition to the weaker macro environment, we reflect TGA's lower production and capex guidance for 2015.

Exhibit 3: TransGlobe valuation summary

				Recoverable reserves			Net Risked	Value per share	
Asset	Country	Diluted WI	CoS	Gross	Net	NPV/boe	value	risked	Unrisked
		%	%	mmboe	mmboe	US$/boe	US$m	US$/share	US$/share
Net (Debt) Cash		100%	100%				57	0.8	0.8
SG&A		100%	100%				(31)	(0.4)	(0.4)
Receivables NPV							107	1.4	1.4
Production									
West Gharib	Egypt	100%	100%	19.4	19.4	10.3	200	2.7	2.7
West Bakr	Egypt	100%	100%	6.6	6.6	6.0	40	0.5	0.5
East Ghazalat	Egypt	50%	100%	0.8	0.4	5.6	2	0.0	0.0
Producing									
*Yemen Block 32 / Block S-1	Yemen	14% / 25%	50%	N/A	N/A	N/A	27	0.4	0.7
Core NAV							402	5.4	5.7
Exploration									
NWG #10	Egypt	100%	15%	32.6	32.6	4.9	24	0.3	2.1
NWG #6	Egypt	100%	15%	11.8	11.8	3.8	7	0.1	0.6
NWG #1-5, 8,9,11	Egypt	100%	25%	11.8	11.8	4.9	15	0.2	0.8
Exploration NAV				1.8			45	0.6	2.1
RENAV							448	6.0	7.8

Source: Edison Investment Research. *Note: In valuing Yemen we adopt the company's carrying value for this asset ($53.3m) and then risk this value by 50%.

TGA's progress in reducing its EGPC receivables balance has partly mitigated the valuation impact of the weaker macro environment. TGA received a material US$140.1m in cash payments against its EGPC receivables balance in Q414. We had previously assumed this debt would be paid over three years, and as such our valuation featured a DCF of our estimated schedule of payments over this period. Given TGA has now a direct marketing agreement in place for its crude, we assume the remainder of the receivables balance (US$120m) is received in 2015, which is again supportive to valuation.

Absolute value 'sense check' shows TGA trading at <1x cash flow at US$80/bbl

As a 'sense check' to our DCF valuation we have assessed TGA's absolute value as at the end of 2014. We estimate TGA held US$58.8m in net cash at year-end 2014, comprised of a US$140.5m gross cash balance offset by debt of c US$82m (corporate bond, end Q314). In addition to US$58.8m in net cash, the group holds a receivables balance of US$120m owed by EGPC. Given the recent progress on payments from EGPC, we value this debt with no discount. Combining these elements results in a net cash and cash equivalent asset value for TGA of US$177.3m.

Netting this US$177m cash balance off against TGA's current market capitalisation of US$228m (at US$3.04/share) implies an EV for the group's operating assets of US$50.7m. It is worth noting as support for the shares that TGA's cash and cash equivalent assets represent US$2.4 of the current US$3 share price. To put this US$50.7m in to context, we note that based on the company's guidance of cash flow sensitivity to oil prices, TGA would generate US$60m in funds flow per year from its Egyptian assets in an US$80/bbl crude price environment. Hence, at the current share price of $3, TGA is trading at less than 1x cash (0.84x) assuming a recovery in crude prices to US$80/bbl.

Exhibit 4: TGA valuation 'sense check'

TGA valuation 'sense check'	US$m	US$ per share
Net cash (Q414)	59	0.78
EGPC receivables balance	120	1.60
Cash 'equivalent' total	179	2.38
Market capitalisation (at $3/share)	228	3.04
Implied EV	49	0.65
Estimated funds flow, assuming US$80/bbl	60	0.80
EV cash flow multiple, assuming US$80/bbl		0.84

Source: Edison Investment Research

On this basis, we see value in TransGlobe shares for the long-term investor willing to look through the temporary oversupply dominating the crude oil market, particularly as the operating backdrop in Egypt continues to improve. Supporting our constructive view of the shares, we retain our US$80/bbl long-term price forecast for 2017 onwards, as we see material production cuts underway in the industry and reduced investment combining to support higher prices as early as 2016.

Balance sheet strength suggests deals are possible

Given the Egyptian government's renewed commitment to repay its foreign company debts, we estimate the remaining balance owed to TGA will be fully paid by the end of 2015. Hence, with TGA holding c US$140m in gross cash and seeking to diversify its assets outside of Egypt, we see near-term M&A activity as highly likely. However, we stress that future deals will likely be geared towards exploiting the group's competence in applying secondary recovery techniques as with Egypt, rather than targeting outsized, high-risk exploration. Given the weak oil price environment we would view this as an opportune time to carry out deals.

Exhibit 5: Financial summary

$'000s	2012	2013	2014e	2015e	2016e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	317,993	315,678	304,034	156,643	230,860
Operating Expenses	(52,367)	(65,791)	(78,299)	(84,147)	(83,353)
Gross Profit	265,626	249,887	225,736	72,496	147,508
EBITDA	236,656	202,407	194,236	48,846	124,458
Operating Profit (before amort. and except.)	189,710	152,993	145,935	697	75,440
Intangible Amortisation	0	0	0	0	0
Exceptionals	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	189,710	152,993	145,935	697	75,440
Net Interest	(13,901)	(9,130)	(7,684)	(7,684)	(7,705)
Profit Before Tax (norm)	175,809	143,863	138,252	(6,987)	67,735
Profit Before Tax (FRS 3)	175,809	143,863	138,252	(6,987)	67,735
Tax	(88,075)	(85,351)	(69,149)	(29,823)	(44,026)
Profit After Tax (norm)	87,734	58,512	69,102	(36,810)	23,710
Profit After Tax (FRS 3)	87,734	58,512	69,102	(36,810)	23,710
Average Number of Shares Outstanding (m)	73.4	74.0	75.1	75.1	75.1
EPS - normalised (c)	119.6	79.1	92.1	(49.0)	31.6
EPS - normalised fully diluted (c)	116.2	65.0	92.1	(49.0)	31.6
EPS - (IFRS) (c)	119.6	79.1	92.1	(49.0)	31.6
Dividend per share (c)	0	0	20	20	20
Gross Margin (%)	83.5	79.2	74.2	46.3	63.9
EBITDA Margin (%)	74.4	64.1	63.9	31.2	53.9
Operating Margin (before GW and except.) (%)	59.7	48.5	48.0	0.4	32.7
BALANCE SHEET					
Fixed Assets	342,621	395,439	428,759	417,610	387,352
Intangible Assets	48,414	89,991	102,970	120,730	129,734
Petroleum Properties	280,895	288,756	309,295	280,386	241,123
Other	13,312	16,692	16,495	16,495	16,495
Current Assets	310,804	280,361	272,535	234,361	283,365
Stocks	0	1,525	864	864	864
Debtors	221,017	148,284	120,000	22,500	22,500
Cash	82,974	122,092	142,002	201,328	250,332
Other	6,813	8,460	9,669	9,669	9,669
Current Liabilities	(48,587)	(38,392)	(35,734)	(35,734)	(35,734)
Creditors	(48,587)	(38,392)	(35,734)	(35,734)	(35,734)
Short term borrowings	0	0	0	0	0
Long Term Liabilities	(168,978)	(137,218)	(131,905)	(131,905)	(131,905)
Long term borrowings	(115,627)	(87,539)	(83,229)	(83,229)	(83,229)
Other long term liabilities	(53,351)	(49,679)	(48,676)	(48,676)	(48,676)
Net Assets	435,860	500,190	533,655	484,332	503,078
CASH FLOW					
Operating Cash Flow	93,992	199,508	148,859	111,340	82,777
Net Interest	0	0	0	0	0
Tax	0	0	0	0	0
Capex (PPE)	(45,386)	(66,703)	(66,857)	(19,240)	(9,755)
Capex (Intangible)	(57,390)	(65,252)	(38,834)	(17,760)	(9,004)
Financing	3,333	1,301	2,479	0	0
Dividends	0	0	(18,743)	(15,014)	(15,014)
Other	86,091	(11,286)	(6,585)	0	0
Net Cash Flow	80,640	57,568	20,319	59,326	49,005
Opening net debt/(cash)	113,293	32,653	(34,553)	(58,773)	(118,099)
HP finance leases initiated	0	0	0	0	0
Other	0	9,638	3,901	0	(0)
Closing net debt/(cash)	32,653	(34,553)	(58,773)	(118,099)	(167,103)

Source: Edison Investment Research, company accounts