

# Primeline Energy Holdings<sup>#</sup>

BBG Ticker: PEH CN

Price: C\$0.20

Mkt Cap: C\$35.7m

BUY

Year to Dec	Revenue (C\$m)	EBITDA (C\$m)	PBT (C\$m)	EPS (C\$)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)
2014A	0.0	(1.4)	(0.8)	(0.0)	n/m	n/m	n/m
2015A	53.1	45.3	25.9	0.2	5.1	6.0	0.8
2016E	52.1	37.5	9.8	0.1	5.2	7.3	3.5
2017E	69.4	54.7	29.0	0.2	3.9	5.0	1.2

SOURCE: Company, VSA Capital estimates.

## Exciting New Exploration Well in East China Sea

Primeline Energy Holdings (PEH)<sup>#</sup> has terminated its previously announced proposed merger with **Loyz Energy Limited (LOYZ SP)** in light of low hydrocarbon prices and commodity volatility. However, PEH keeps its external growth strategy and will continue to engage with LOYZ whilst also looking for other opportunities. Moreover, PEH retains its intention to list its shares independently on an additional Stock Exchange in the near future.

### Two Exploration Wells Secured

PEH has secured its two exploration well programme through the US\$20m convertible bond funding. The first well (LS23-1) was spud in September on Block 33/07 and should be completed by the end of October. It targets 36.5bcf of gross risked resources within several zones in Palaeocene sediments. The second well is expected to be drilled within the next 6 months and holds the potential of further de-risking PEH's East China Sea assets. Exploration is key to PEH success as it needs to find more gas in order to capitalise on its existing large hub infrastructure. The company has the capacity of quickly tying in to the gas hub and commercialising any discovery.

### Lower Offtake Volumes Than Expected

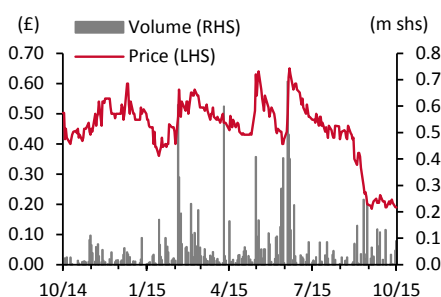
Following PEH's last quarterly results for the period ended 30 June, we have seen a significant reduction in offtake volumes from Zhejiang gas distributor due to its negative view on the high price it believed it was paying to PEH. As a consequence, PEH's revenues fell 91% QoQ to C\$1.2m.

The slowdown in China's economy, its gas pricing policy, as well as the increase in pipeline infrastructure and LNG terminals across the East Coast of China has led to a pronounced oversupply of gas in the region. Whilst the other main suppliers in the region have lowered prices in response to this, PEH has not done so and confirms that the current offtake agreement is still valid. As such, Zhejiang Gas is still liable for the annual "take-or-pay" volume of 195mcm for FY15, even though we believe a small portion the payment should be deferred to FY16. PEH and CNOOC are actively thinking of a new long-term price adjustment mechanism.

#### Company Description

Primeline is an independent oil and gas exploration and production company focusing exclusively on upstream opportunities in China.

#### One Year Price Performance



Price % chg	1mn	3mn	12mn
	+0%	-44.4%	-37.0%

12mn high/low: C\$0.65/C\$0.19

SOURCE: FactSet, as of 07/10/15 close.

Market:	TSX Venture
Price target:	C\$1.20
Shares in issue:	178.7m
Free float:	2.8%
Net debt (2015A):	C\$239.3m
Enterprise value:	C\$275.4m
Next news:	Exploration well results

#### Major shareholders

Hwang Yiou Hwa	70.1%
FIL Investment Management	5.7%

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# Valuation

For the purposes of our valuation, we take into account PEH's 49% share of production, costs and profits which now includes the 12.25% interest previously held by PEH's partner PPC, increasing the asset base by one-third. In addition, CNOOC already holds a 51% stake in the LS36-1 Gas Field, and has the right to back in to a WI of up to 51% in any other commercial development in the remainder of Blocks 25/34 and 33/07, by paying pro-rata development costs. We therefore assume 49% equity in any commercial development on both blocks for PEH.

We take the opportunity of this note to roll forward our DCF discounted to 1 January 2016. We have included into our valuation the LS23-1 exploration well which has already started drilling in September, and we anticipate PEH to drill its biggest prospect, the LS 30-3, targeting 44.7bcf of gross risked resources within the next 6 months.

Despite the appreciation of the C\$/US\$ exchange rate and the addition of a second exploration well which support PEH's value, lower commodity prices as well as the decrease in PEH's 2P reserves as a consequence of the LS36-1 Gas Field steady production, are balancing our valuation and contributes to a slight decrease of our risked NAV.

## NAV Table

Producing NAV	Gross risked mboe	Equity %	EMV US\$m	Net risked C\$/share
LS36-1	13.2	49%	273	199
<b>Total</b>	<b>13.2</b>		<b>273</b>	<b>199</b>
<b>Financing NAV</b>			<b>-252</b>	<b>-184</b>
<b>Contingent NAV</b>				
LS36-1 Paleocene M1 0	0.8	49%	5	3.3
LS36-1 Paleocene M1 1 S	0.6	49%	3	2.5
LS36-1 Paleocene M2	1.9	49%	11	8.2
LS36-1 Paleocene M3	4.3	49%	25	18.6
LS36-1 Paleocene L1	2.7	49%	16	11.7
LS36-1 Paleocene L2	0.4	49%	3	1.8
LS30-8 Paleocene M2	1.3	49%	7	5.4
<b>Total</b>	<b>12</b>		<b>71</b>	<b>52</b>
<b>Exploration NAV</b>				
LS23-1	6	49%	33	23.9
LS30-3	7	49%	40	29.4
<b>Total</b>	<b>14</b>		<b>73</b>	<b>53</b>
<b>Total</b>			<b>165</b>	<b>120</b>

SOURCE: VSA Capital estimates.

## Recommendation and Target Price

Whilst we are disappointed to see that the LOYZ corporate transaction didn't complete, we remain confident in PEH's strategy along its major partner CNOOC. PEH is trading near its core NAV, exposing investors to a significant upside from its contingent and exploration resources and has funded two relatively low risk wells in the next six months which should begin to de-risk this.

We maintain our **BUY recommendation and decrease our target price from C\$1.30 to C\$1.20**, in line with our risked NAV using a US\$14.5/mcf gas price discounted to 1 January 2016 (8% WACC). We keep our view of a supportive gas demand in China and Asia in general over the long term. Risks to our target include a slower than expected ramp-up of production, lower gas prices in China and weak exploration results.

## Income Statement

Year to march (\$Cm)	2014	2015	2016e	2017e
Brent Oil Price Average (USD/bbl)	99.4	60	50	50
China Spot (US\$/mcf)	14.5	14.5	14.0	14.0
USD:CAD	1.1	1.2	1.3	1.3
CAD:RMB	5.6	5.0	4.8	4.8
Production (kboe/d)	-	1.9	1.9	2.6
O&G entitled production rate (boe/d)	-	1.9	1.9	2.6
Revenues	-	53.1	52.1	69.4
EBITDA	(1.4)	45.3	37.5	54.7
Depreciation	-	(15.0)	(15.0)	(15.0)
Consolidated operating income	(1.4)	30.2	22.4	39.7
Profit before income tax	(0.8)	25.9	9.8	29.0
Tax charge	-	-	-	-
Net income/(Loss)	(0.8)	25.9	9.8	29.0
<b>Per share data</b>	<b>2014</b>	<b>2015</b>	<b>2016e</b>	<b>2017e</b>
Average number of shares outstanding (basic)	99.9	112.8	178.0	178.0
Basic EPS (C\$/sh)	(0.01)	0.23	0.06	0.16
Average share price (C\$/sh)	0.63	0.19	0.19	0.19

*SOURCE: Company data, VSA Capital estimates. We include Trial production into the P&L for 2015.*

## Cash Flow Statement

Year to march (\$Cm)	2014	2015	2016e	2017e
Profit before tax	(0.8)	25.9	9.8	29.0
DD&A	0.0	15.0	15.0	15.0
Finance expense	(0.5)	4.0	4.0	4.0
Other non-cash items	0.1	2.6	-	-
<b>Cash flow from operations</b>	<b>(1.3)</b>	<b>47.6</b>	<b>28.9</b>	<b>48.0</b>
Disposals	-	-	-	-
Debt	2.7	256.2	26.0	-
Shares issued	(0.5)	-	-	-
<b>Total sources of funds</b>	<b>0.9</b>	<b>303.7</b>	<b>54.9</b>	<b>48.0</b>
Capital expenditures	-	(256.9)	-	-
Acquisitions	-	-	-	-
Dividends	-	-	-	-
Exploration Expenses	(2.6)	(8.9)	(8.9)	(8.9)
Repayment of debt & interest	-	(24.7)	(52.9)	(50.9)
Other	5.1	(1.3)	-	-
<b>Total sources of funds</b>	<b>0.9</b>	<b>303.7</b>	<b>54.9</b>	<b>48.0</b>
Working capital changes	0.1	(6.0)	1.3	2.2
<b>Cash Flow surplus/(deficit)</b>	<b>3.5</b>	<b>5.9</b>	<b>(5.6)</b>	<b>(9.5)</b>

*SOURCE: Company data, VSA Capital estimates.*

## Balance Sheet

Year to march (\$Cm)	2014	2015e	2016e	2017e
Non Current Assets	82.3	373.4	367.2	361.1
Current Assets	4.5	18.7	13.0	3.5
Of which: Cash	4.4	10.9	5.2	(4.3)
<b>Total Assets</b>	<b>86.9</b>	<b>392.0</b>	<b>380.3</b>	<b>364.6</b>
LT Debt	-	230.0	257.0	217.0
Other Long Term Liabilities	5.5	26.7	26.7	26.7
Current Liabilities	0.4	43.7	43.7	43.7
<b>Total Liabilities</b>	<b>6.0</b>	<b>300.4</b>	<b>327.4</b>	<b>287.4</b>
Equity - Group share	80.9	91.6	52.9	77.2
<b>Total Equity &amp; Liabilities</b>	<b>86.9</b>	<b>392.0</b>	<b>380.3</b>	<b>364.6</b>

*SOURCE: Company data, VSA Capital estimates.*

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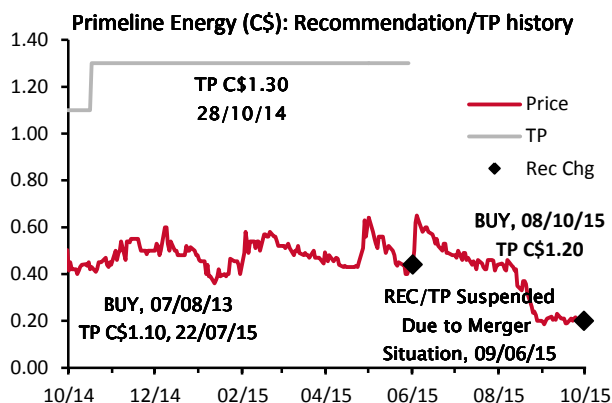
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Equities breakdown: 30 June 2015	Spec. BUY	BUY	HOLD	SELL
Overall equities coverage	26.3%	68.4%	5.3%	0.0%
Companies to which VSA has supplied investment banking services	25.0%	75.0%	0.0%	0.0%

## Recommendation and Target Price History



SOURCE: FactSet data, VSA Capital estimates.

### Valuation basis

We value PEH using a combination of discounted cash flow (DCF) analysis of the LS36-1 field and a risked net asset appraisal of the exploration portfolio (RENAV).

### Risks to that valuation

Risks to our target include a slower than expected ramp-up of production, lower gas prices in China and weak exploration results. This recommendation was first published on 7 August 2013.