

Issuer Sponsored
Current price 9.4p
Oil & Gas
UK/Australia/Botswana

Tlou Energy+

Maintaining the momentum

FTSE AIM All-Share	1,027
Reuters/Bloomberg	TLOU
Shares in issue (m)	329.5
Market Cap (£m)	31.0
Net Cash (£m) (Dec '17)	4.2
Enterprise Value (£m)	26.8
Website	www.tlouenergy.com

Next update

Follow-on core drilling Q2 CY2018

Performance	1M	3M	12M
Absolute (%)	(36)	(23)	21
Rel Index (%)	(30)	(25)	55
Relative to	FTSE AIM Oil & Gas Index		

Assumed GBP/USD exchange rate: 1.40
 Assumed GBP/AUD exchange rate: 1.80
 Assumed AUD/USD exchange rate: 0.80

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Please see page 6 for a glossary of common abbreviations.

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Hot on the heels of an impressive reserves upgrade, Tlou released interim results (for the six months to December 2017) on 22nd February, reiterating strong progress and providing some great colour on the forward strategy. Tlou has successfully established itself as the most advanced gas-to-power developer in Botswana and, with a significant increase in 2P reserves now in the bag, it appears clear that recent seismic data acquisition and core-hole drilling activities have been most successful. We see excellent scope for further reserve upgrades as work continues and, despite the Botswanan government's planned re-tender to RFP bidders, Tlou has outlined a clear roadmap for this year, including additional core-hole drilling and seismic data acquisition, the active pursuit of grid connection options and the targeted commencement of development drilling in mid-2018. Ahead of news on offtake arrangements and development financing, we believe it is important to recognise the continued operational momentum at Lesedi and Mamba, and upgrade our fair value estimate to 30p/share (25p/share previously).

Upgraded reserves comfortably exceed initial commercial threshold: On 20th February, Tlou released what was, in our opinion, a cracking reserves upgrade, confirming a 944% increase in 2P reserves to circa 41bcf. We believe that this latest independent reserves assessment is of particular importance, as it now seems clear that Tlou has sufficient 2P reserves to underpin first phase commercial development (we had previously assumed that 20bcf would be required to support an initial 10MW gas-to-power scheme).

Actively pursuing grid connection options: Despite the Botswanan government's planned re-tender process, Tlou reports that its grid connection plans are well advanced, with the company evaluating various offtake routes including possible electricity sales into the SAPP network. We note that Tlou continues to target the commencement of development drilling later this year so, whilst there will have been some slippage, we see good scope for first power in early CY2020 (versus our prior expectation of late CY2019).

Fair value estimate upgraded to 30p/share: We continue to believe that a reserves-based approach is appropriate at this stage and have upgraded our fair value estimate to 30p/share (25p/share previously). Our latest assessment incorporates Tlou's substantially upgraded 2P reserves, partly offset by currency movements and placing-related dilution. Ahead of the confirmation of offtake and financing arrangements, we believe it is important to recognise the value of Tlou's strategically-important and growing reserves base.

Results and Forecasts

Year to	Revenue	Adj PBT	Adj EPS	DPS	Net cash	PER	EV/EBITDA	Div Yield
June	(A\$m)	(A\$m)	(c)	(c)	(A\$m)	(x)	(x)	(%)
2017A	0.0	(3.2)	(1.3)	-	6.7	n/a	n/a	n/a
2018F	0.0	(3.4)	(1.1)	-	4.7	n/a	n/a	n/a
2019F	0.0	(3.3)	(1.0)	-	(4.8)	n/a	n/a	n/a

Source: Tlou Energy; Shore Capital Markets

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Pursuing a clear roadmap in Botswana

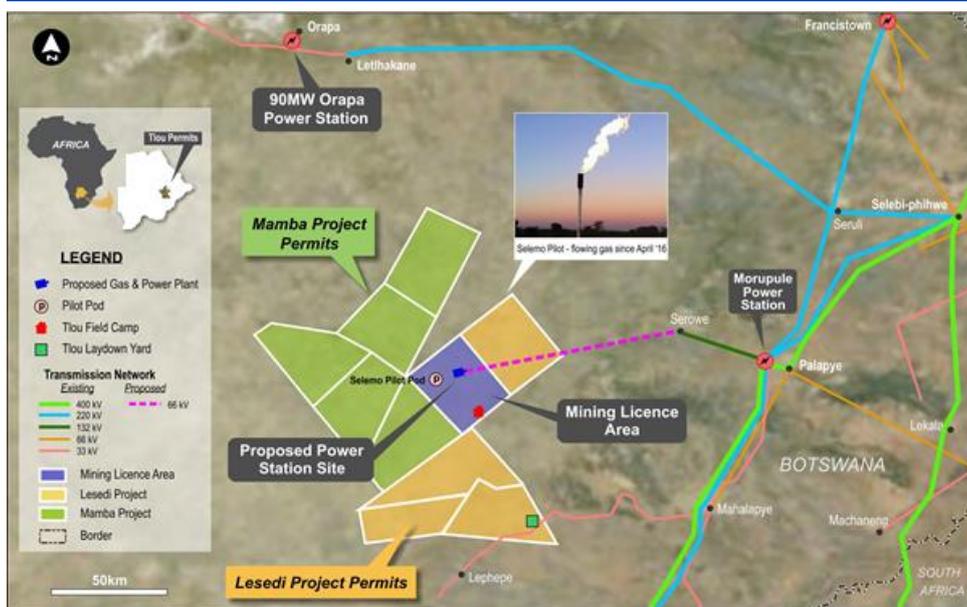
Recent interims reiterated strong progress including an impressive reserves upgrade

Released a couple of days after the company’s impressive reserves upgrade on 20th February, Tlou’s interim results (for the six months to December 2017) reiterated strong progress and provided some very useful colour on the strategy going forward. Having already successfully established itself as the most advanced gas-to-power developer in Botswana, we believe that Tlou has proved itself to be a forerunner in several respects, including as the first operator in country to possess a CBM mining licence, environmental approval for field development and independently assessed CBM gas reserves. With a very considerable increase in 2P reserves (as assessed by consultants SRK) now in the bag, it seems clear to us that recent seismic data acquisition and core-hole drilling activities have been most successful and we see excellent scope for further reserves upgrades as work continues; alongside the active pursuit of grid connection options, we expect the expansion of its reserves base to be a priority for Tlou in the coming months.

Actively pursuing development drilling and grid connection plans

Despite the Botswanan authorities’ planned re-tender to RFP bidders (announced on 12th February), Tlou has since outlined a clear near-term roadmap, including potential rig purchases to provide more operational control, additional core-hole drilling and seismic data acquisition, and the targeted commencement of development drilling in mid-2018. In addition, Tlou is actively pursuing grid connection options (such as the sale of power into the SAPP transmission network and potentially including an element of solar generation to complement the company’s gas). In relation to the planned RFP re-tender, we expect both sides to pursue an improved match between project requirements and deliverability and therefore still believe that this could provide a realistic offtake solution in due course. So, overall, we were very encouraged by commentary in the interim results and continue to fully expect successful development of the flagship Lesedi project, which we believe is ideally situated to satisfy the high levels of power demand in the Southern African region.

Figure 1: Tlou project location map



Source: Tlou Energy

2P reserves clearly underpin commercial viability

The recent reserves update confirmed a 63% increase in 3P gas reserves to circa 427bcf and a 944% increase in 2P reserves to circa 41bcf (see Fig. 5). These reserves numbers have been independently assessed by consultancy SRK (incorporating the latest seismic and core-hole data) and clearly indicate increased reserves combined with a higher level of confidence at Lesedi and Mamba. With pilot wells successfully flow tested, we believe that this latest reserves upgrade is of particular importance, as it now seems clear that Tlou has sufficient 2P reserves to underpin first phase commercial development (we had previously assumed that 20bcf would be required to support an initial 10MW gas-to-power scheme). So, whilst recent news of the planned RFP re-tender was met with a negative reception by investors, we believe that this has been substantially negated by SRK's latest reserves assessment, which further demonstrates commercial viability as Tlou remains busy with its various parallel workstreams and actively targets first power in around 24 months' time.

Cornerstone investment by African Alliance sets a very encouraging precedent

We have updated our P&L and cash flow forecasts (see Fig. 2 and Fig. 3) through FY2019, during which time Tlou remains in the pre-revenue phase and we assume the maintenance of annual operating expenses (including central costs) at just over A\$2.5m. We assume total FY2018 capex of A\$3m (rising to A\$6m in FY2019, when we expect development drilling to commence). The company is also considering a potential rig purchase to improve operational effectiveness and reduce well costs. In its interim results, Tlou reported net cash of A\$7.5m at 31st December 2017, implying the need for a longer term financing solution. However, we expect Tlou to continue to pursue discussions with potential project development and funding partners and highlight the company's successful listing on the Botswana Stock Exchange. This was part of a strategy to attract local development capital, which has already translated into an important cornerstone investment by Botswanan asset manager African Alliance. African Alliance's assets under management include government pension funds and its support sets a very encouraging precedent, we believe.

Fair value estimate upgraded to 30p/share

With feasibility studies to be finalised along with project financing and offtake arrangements, we continue to base our sum-of-the-parts valuation (see Fig. 6) on certified gas volumes. These will, we believe, play an important role in eventual project financing negotiations (e.g. regarding the equity interest that Tlou subsequently retains in its planned integrated gas-to-power scheme). This Risked NAV approach takes mid-case reserves (recently upgraded) and contingent resources, risking the latter with an increased 50% probability of success to reflect scope for an upgrade here too (including at Mamba, which contains reserves but doesn't yet have contingent resources attributed to it). Our assumed per unit NPV of US\$1/mcf remains consistent with other African gas projects assessed by us and attributes a value exceeding US\$140m to Tlou's 100% interest in Lesedi and Mamba, at the current stage. Adjusting for prevailing exchange rates, new placing shares issued and financial items such as the present value of central costs, we upgrade our fair value estimate from 25p/share to 30p/share (versus Tlou's current 9.4p share price).

Figure 2: Tlou Energy profit & loss (A\$'000)

Year-end June	2017A	2018F	2019F
Turnover	-	-	-
Cost of sales	-	-	-
Gross profit	-	-	-
Operating expenses	(2,109)	(2,600)	(2,700)
Share based payments	(423)	(400)	(400)
Share issue costs	(357)	(177)	0
Depreciation and amortisation	(241)	(200)	(200)
Operating loss	(3,130)	(3,377)	(3,300)
Net interest	2	2	1
Foreign exchange gain/(loss)	(37)	0	0
Loss before tax	(3,165)	(3,375)	(3,299)
Tax	0	0	0
Net loss	(3,165)	(3,375)	(3,299)
Average shares in issue (m)	245.7	306.8	329.5
Basic loss per share (cents)	(1.3)	(1.1)	(1.0)

Source: Tlou Energy; Shore Capital Markets

Figure 3: Tlou Energy cash flow (A\$'000)

Year-end June	2017A	2018F	2019F
Payments to suppliers and employees	(2,446)	(3,600)	(3,700)
Interest received	2	2	1
Tax received	99	200	200
Operating cash flow	(2,345)	(3,398)	(3,499)
Capital expenditure	(1,953)	(3,000)	(6,000)
Free cash flow	(4,298)	(6,398)	(9,499)
Share issues (net)	9,776	4,391	0
Net cash flow	5,478	(2,007)	(9,499)
Foreign exchange differences	25	0	0
Opening net cash	1,224	6,727	4,720
Closing net cash	6,727	4,720	(4,779)

Source: Tlou Energy; Shore Capital Markets

Figure 4: Tlou asset summary table

Asset	Location	Status	Operator	Tlou working interest	Key next steps
Lesedi CBM	Botswana	Appraisal and development	Tlou	100%	Initial development drilling (from mid-2018)
Mamba CBM	Botswana	Appraisal	Tlou	100%	Further core-hole drilling (commencing Q2 CY2018)

Source: Tlou Energy; Shore Capital Markets

Fig 5: Tlou CBM gas reserves and resources

Location	Project	Tlou interest	Gas reserves (bcf)			Gas contingent resources (bcf)			Gas prospective resources (bcf)
			1P	2P	3P	1C	2C	3C	Best estimate
Karoo Basin Botswana	Lesedi CBM (Lower Morupule)	100%	0.3	25.2	252	4.6	45.6	331	-
Karoo Basin Botswana	Lesedi CBM (all coal seams)	100%	0.3	25.2	252	4.6	214	3,043	-
Karoo Basin Botswana	Mamba CBM (Lower Morupule)	100%	0.0	15.5	175	n/a	n/a	n/a	-
Karoo Basin Botswana	Lesedi CBM (exploration)	100%	-	-	-	-	-	-	8,596
Total gas volumes (Lesedi and Mamba CBM) (all coal seams)			0.4	40.8	427	4.6	214	3,043	8,596

Source: Tlou Energy; SRK; Netherland Sewell

Figure 6: Tlou sum-of-the-parts valuation summary

	Unrisked	CoS*	Risked	Unrisked	Risked	Risked
	US\$m	%	US\$m	US\$/share	US\$/share	£/share
2P reserves	40.8	90	36.7	0.12	0.11	0.08
2C contingent resources	214.0	50	107.0	0.65	0.32	0.23
Reported net cash (Dec '17)	6.0	100	6.0	0.02	0.02	0.01
PV central costs	(13.4)	100	(13.4)	(0.04)	(0.04)	(0.03)
Risked NAV	247.4	-	136.3	0.75	0.41	0.30

Assumed GBP/USD exchange rate: 1.40

Source: Shore Capital Markets. *Chance of Success.

Assumed AUD/USD exchange rate: 0.80

Common abbreviations

1P	Proved
2P	Proved + Probable
3P	Proved + Probable + Possible
BCF	Billion Cubic Feet
BFS	Bankable Feasibility Study
BOE	Barrels of Oil Equivalent
CBM	Coalbed methane
EPC	Engineering, procurement and construction
GIIP	Gas Initially In Place
GSA	Gas Sales Agreement
GTP	Gas-to-power
IPP	Independent Power Producer
kWh	Kilowatt-hour
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
MBOE	Thousand Barrels of Oil Equivalent
MCF	Thousand Cubic Feet
MMBOE	Million Barrels of Oil Equivalent
MMCFD	Million Cubic Feet per Day
MW	Megawatt
O&M	Operations and maintenance
PPA	Power Purchase Agreement
PSC	Production Sharing Contract
RFP	Request for Proposal
SAPP	Southern African Power Pool
TCF	Trillion Cubic Feet

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