

Carnarvon Petroleum Ltd

(CVN \$0.13) Speculative Buy

Analyst	Date	Price Target
Jon Bishop	19 th October 2016	\$0.25/sh

Prolific Flow Test at Roc-2

Investment case

Prolific flow test results extrapolated to over 23,000boepd on an unconstrained basis, will attract significant industry interest to the Bed-Out Sub-Basin. CVN has established commercial flow rates from a new play but significantly, located in a politically and fiscally benign jurisdiction, proximal to a mature oil and gas industry. At a <\$60m EV, an open register, est. \$75m in cash and a material gas and oil resource inventory, CVN will be increasingly attractive to industry looking for brown field and appraisal opportunities as the oil price cycle turns. We retain our Speculative Buy recommendation with an increased Price Target of \$0.25/sh.

Key points

- Controlled flow testing at Roc-2 over 5 days have delivered rates of up to 51.2mmscf/d and 2,943bopd of condensate;
- This equates to 11,476boepd and was constrained by testing equipment;
- Extrapolated (unconstrained) rates est. at 100mmscf/d and ~6,000bopd of associated condensate (~23,000boepd);
- Negligible CO₂ and H₂S, and exhibited little or no sand ingress or produced water;
- Commercial flow rates warrant an upgrade to our assessment of in-ground resources – this supports a \$0.265/sh Valuation;
- We set a \$0.25/sh Price Target (prev. \$0.15/sh);
- Upcoming catalysts include:
 - Volumetric review of the Roc, Phoenix and Phoenix South discoveries as well as the broader prospect portfolio (Dorado, Bewdy, Bottler etc);
 - Deepening of the Phoenix South discovery to test the Caley Sandstone;
 - Drilling the Dorado Prospect (+3x size of Roc);
- With an open register, est. \$0.075/sh in cash and an EV of <\$60m CVN is cheap and offers a compelling investment case particularly when compared to FAR's \$300m EV as its nearest proxy.

Analysis

We believe that demonstration of material flow rates has re-established the Bed-out Sub-Basin on the NWS, as a new oil and gas frontier.

Rates of 11,500boepd constrained are better than any of the recent discoveries made by ASX listed oil and gas companies offshore (see FAR, KAR):



Source: Company Reports

Carnarvon Petroleum Ltd	Year End 30 June	
Share Price	0.130	A\$/sh
Price Target	0.25	A\$/sh
Valuation	0.31	A\$/sh

Shares on issue	1021	m, diluted
Market Capitalisation	133	A\$m
Enterprise Value	58	A\$m
Debt	0	A\$m
Cash est.	75	A\$m
Largest Shareholder		Mgmt -6%

Directors

P Leonhardt	Chair
A Cook	MD
T Jacobson	NE Dir
W Foster	NE Dir
P Moore	NE Dir

Shareholders

Mgmt	-6%
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Share Price Chart



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They are comparable and in many cases, in excess of the early tests of the North Rankin-Goldwyn discoveries (albeit utilising equipment of the day).

Similarly, the extrapolated rates of +23,000boepd are akin to the early NWSJV producers save for reservoir thickness (ie NRA and Goodwyn up to 400m thickness).

As a consequence we view that the market will revalue the discovered resources which were last estimated at:

- Roc - 463Bcf & 22mmbbls;
- Phoenix South - 19mmbbls;
- Phoenix - 9mmbbls.

Test data should have a positive bearing on recoverable volumes at Roc

Upgrade to Valuation and Price Target

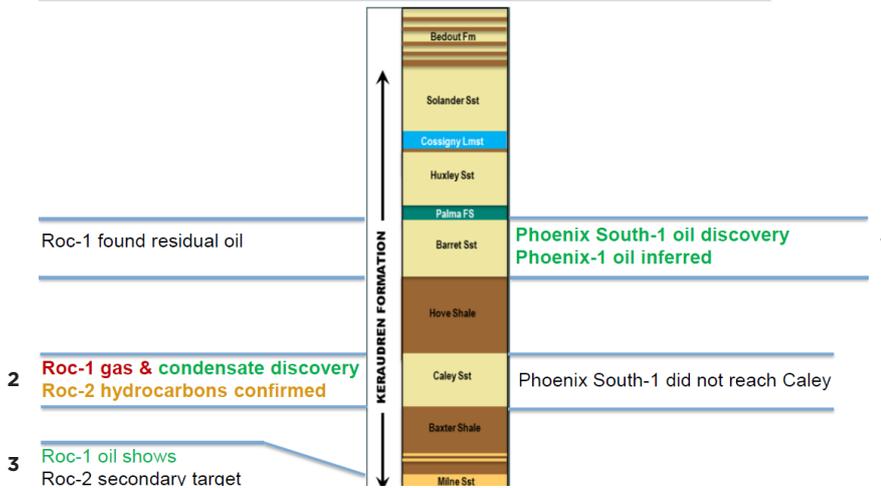
Establishing commercial flow rates have warranted an upgrade to our assessment of in-ground resources.

CVN's 20% net interest of circa 24mmbboe at an in-ground valuation of A\$10/bbl, plus circa \$75m est. cash underpins a 313m market capitalisation.

This supports a \$0.31/sh Valuation. We set a \$0.25/sh Price Target (prev. \$0.15/sh) reflective of the lead time to possible commercialisation pathways.

Implications for Industry

CVN's success in the permits to date has effectively established at least three new play types deriving hydrocarbons from a new source rock.



Source: Company Report

First and foremost, the JV will be keen to assess the deeper potential of the Caley Sandstone at the Phoenix South location noting that the discovery well TD'd above this interval.

In addition, the emergence of these Triassic plays, brings into play a material number of prospects and leads within the portfolio - the large Dorado structure to the SW of the Roc location would be an obvious priority.

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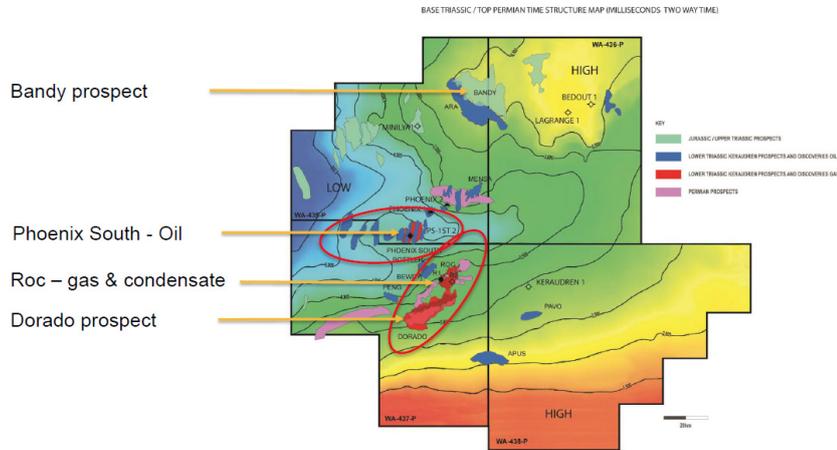
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We note that current interpretation of the new 3D seismic is that it is an extension to the Roc structure:



Source: Company Reports

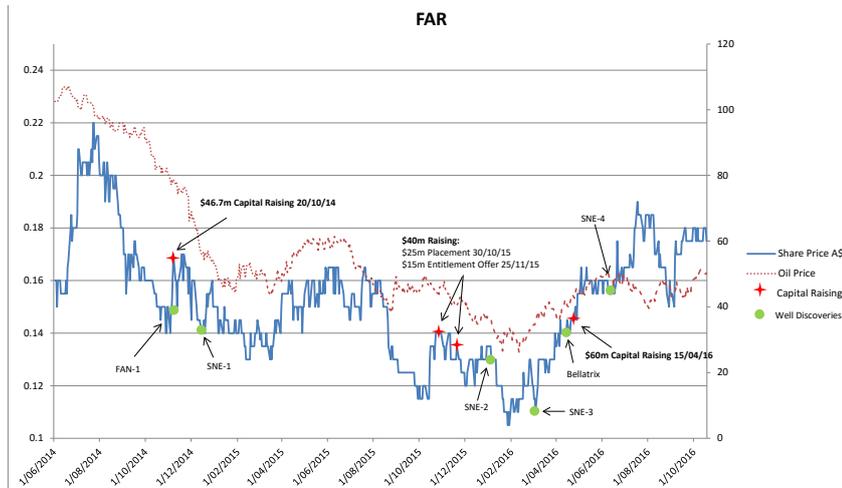
At over 3 times the aerial extent of Roc and noting that Roc is not closed-off ie potential for the closure as mapped to increase in size, Dorado is a material target that could underpin a development of over 1.5Tcf and over 100mbbls of associated condensate.

As a consequence, we suspect that the test results will attract significant industry interest not only on account of prolific flow rates of gas and condensate from a new play with substantial prospect potential but significantly, located in a politically and fiscally benign jurisdiction, proximal to a mature oil and gas industry.

Comparison to FAR

FAR has had success with its offshore Senegal exploration drilling campaign making a non-commercial discovery at FAN-1 and what is shaping to be a potential commercial discovery at SNE.

Successful flow tests and appraisal drilling has substantiated a \$300m EV despite several large raisings (in order for FAR to continue to participate heads-up in what is costly appraisal and exploration drilling):



Source: Company Reports and Iress

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Whilst we acknowledge that in size and hydrocarbon mix, FAR's 15% of the discovery 2C Resource warrants a higher EV today (than CVN), the table below – in the context of the broader prospectivity that the flow test results had effectively high graded – highlights the relative merits that CVN's discoveries offer over and above FAR's:

	FAR	CVN
Jurisdiction	off-shore West Africa	NWS Australia
Industry Maturity	Minimal oil & gas history	Establish mature O&G industry
Volume (100% 2C)	641mmbbls	120mmbboe (40% oil)
API	32o	48o
Water Depth	+900m	-100m
Interest	15%	20%
Peak test rate	8000bopd	11500boepd
Development capex (A\$) est.	\$12.6Bn (US\$15/boe)	\$1Bn (US\$6.50/boe)
Development concept	FPSO	Wellhead Platform-FSO with pipeline to shore
Cash est	\$50m	\$75m
Mkt Cap	\$360m	\$133m
EV	\$310m	\$58m
EV/2C	\$3.40/boe	\$2.40/boe

Source: Company Reports and EZL est.

On an equivalence basis, applying FAR's implied EV:2C of \$3.40/boe supports a \$0.19/sh share price for CVN.

In due course, with further discoveries at Phoenix South (in the Caley Sandstone) and at the broader prospect portfolio (Dorado et al), the relatively lower development cost – on account of water depth, recovery rates, proximity to shore and grade of oil – suggests that CVN can ultimately command a higher EV.

Ultimately either the market 'discovers' this relative discount CVN currently trades and/or industry (very likely in our view) seizes upon a cheap exposure to a material new province within an established, stable and proven oil and gas jurisdiction.

With an open register and \$0.075/sh in est. cash, CVN is cheap and offers a compelling investment case.

Upcoming catalysts include:

- Volumetric review of the Roc, Phoenix and Phoenix South discoveries as well as the broader prospect portfolio (Dorado, Bewdy, Bottler etc);
- Deepening of the Phoenix South discovery to test the Caley Sandstone;
- Drilling the Dorado Prospect (+3x size of Roc).

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