Block Energy (BLOE LN)

MARKET DATA

Bloomberg	ticker	BLOE LN
Share price	p/shr	1.05
Target	p/shr	4.0
TP upside	%	281%
Shares out	Million	724.7
Fd shares	Million	888.1
Mkt cap	US$m	9.6
EV	US$m	9.0

DESCRIPTION

Block Energy is the largest oil and gas company in the country of Georgia. The company's assets include 100% stakes in the West Rustavi oil and gas field, as well as licence XIB – historically Georgia's most productive licence, which has produced over 180 mmbbls during Soviet ownership. The asset base also includes wildcat exploration opportunities, with multi-TCF deep gas potential.

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CODE BREAKERS

Block Energy is seemingly cracking the code to unlocking the substantial opportunity across its vast acreage position in Georgia. Since listing on AIM c.5 years ago, the company has enjoyed mixed successes at the drill bit. The company's latest well however marks its third success in a row, with its latest three wells flowing at initial sustained rates of c.344, 269 and 150 boepd, respectively. These wells are paying back over a period of around 3-8 months, meaning that each successful well can have a snowball effect on group production and cash flow. This ensures that at a minimum the company can be self-sufficient in its growth, with discretionary cash becoming available for higher impact opportunities in due course. These opportunities could include the appraisal and re-development of Block XIB – historically the country's most productive licence, and referred to by the Company as "Project II" – or deep gas appraisal drilling (Project III) which, having been confirmed by over 40 gas tests during the Soviet period, is expected to offer multi-Tcf potential. Next year we forecast annual EBITDA of US$6m, rising to US$11m the following year as additional Project I development wells come onstream. As discretionary cash flow builds, we see material catalysts added to the near-term work programme, which should serve to reignite interest in the company. We carry an updated 4.0p/shr target price, offering over 3x upside.

Figure 1: Summary financial forecasts

		2023	2024	2025
Production	**boepd**	**591**	**653**	**1,089**
Revenue	US$m	10.9	12.1	18.9
Operating costs*	US$m	(5.8)	(6.1)	(8.0)
EBITDA	**US$m**	**5.1**	**6.0**	**11.0**
EV/EBITDA	X	1.8x	1.5x	0.4x
Capex	US$m	(5.0)	(6.0)	(6.0)
Free cash flow	**US$m**	**0.1**	**0.0**	**5.0**
Net cash (debt)	US$m	0.6	0.6	5.5

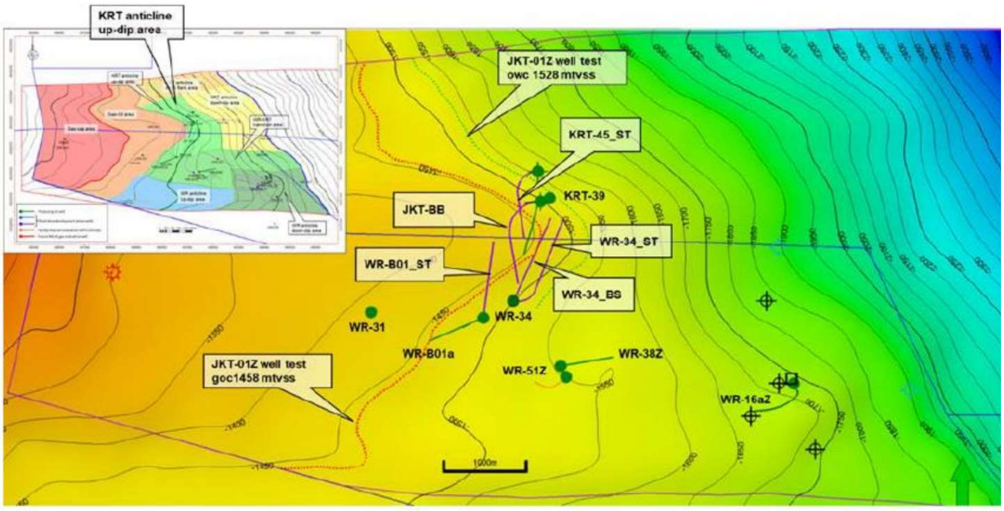
Sources: Tennyson Securities. *Opex plus G&A

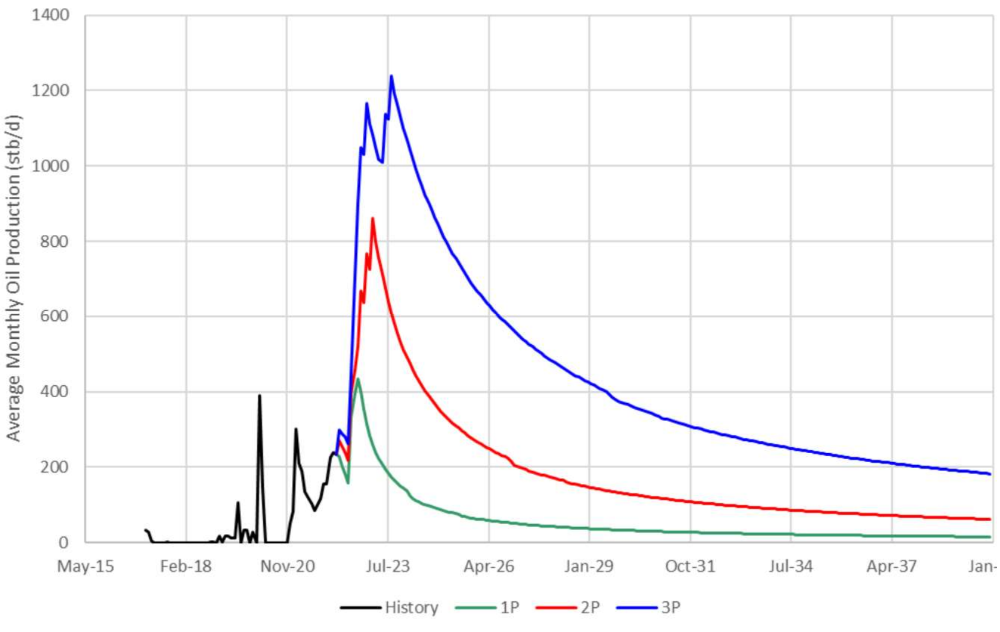
Block has amassed the largest acreage position in Georgia, with 100% stakes in 4 PSCs, including six oil and gas fields. The portfolio includes producing, development, appraisal and exploration assets, which Block has pigeon-holed into four "Projects". Project I is the development of the main producing asset in the portfolio – the West Rustavi/Krtsanisi field. Since listing in late 2018, the company has drilled a number of successful development wells on the field, and installed infrastructure including gas processing facilities. Project I sees the continual drilling of low risk development wells, reinvesting cash flow to build production and provide the platform for growth through the other projects. Project II is the re-development of the Patardzeuli oil field, which once produced 60,000 bopd during Soviet ownership and is estimated to contain over 200 mmbbls of 2C resources. Project III is the appraisal of a number of legacy gas discoveries, containing an estimated 860 Bcf 2C resources, and Project IV includes high impact exploration of deep gas potential.

Project I – West Rustavi/Krtsanisi: A marked change in group production commenced over the course of the first half of this year, with Block bringing onstream the development wells WR-B01Za and WR-34Z, following on from last year's successful JKT-01Z well. These wells were all drilled on the West Rustavi/Krtsanisi field, and were the first drilled with the benefit of new 3D seismic over the area. This new seismic has substantially improved subsurface imagery, allowing for more accurate mapping of fracture zones in particular, which is key to reservoir productivity. The latest three wells in this area have averaged initial production rates of 254 boepd, and we would expect the next couple of wells in the drilling programme at least to be broadly consistent in terms of productivity.

Block's CPR on the Krtsanisi anticline assumed a total of five additional wells drilled in the area, of which Block has now completed two. Assuming the programme continues to be followed, Block's next wells will include KRT-45Z, JKT-BB and WR-34_BS (see Figure 2, below). The CPR assumed all five wells were drilled in quick succession, which contributed to total peak production in H1 2023 at just under 900 bopd, plus 0.75 mmscf/d (c.125 boepd) associated gas. Two wells in, Block is already at around 485 bopd plus c.150 boepd of gas, indicating that it is well on track to surpass the 2P peak production outlined in the CPR. Furthermore, we believe that, given the performance of JKT-01 and WR-B01Za to date there is a good chance that the field performs closer to the 3P case, which sees oil production from a total of eight wells peaking at a rate of just over 1,200 bopd.

Figure 2: CPR case drilling plan and oil production profile





Source: ERCE, Block Energy

The core Krtsanisi area contains an estimated 3 mmbbls of 3P reserves according to ERCE, with a further 19.5 mmbbls of 2C contingent resources across the rest of the West Rustavi field based on an internal Block Energy estimate. This provides ample scope for continuous development drilling in order to incrementally increase base production levels, above the CPR reserve profiles outlined above. Block's own internal forecasts suggest that under the full field development scenario, production from West Rustavi is anticipated to continue growing over the next seven or eight years, peaking at rates of over 3,000 bopd.

Project II – Patardzeuli: The second leg to Block's strategy is a redevelopment programme at its Patardzeuli field, located in block XIB. Patardzeuli was developed by the Soviets in the mid-1970s, with production growing steadily to a peak of just shy of 60,000 bopd in the early 1980s, before declining rapidly – effectively to zero – over the course of just a couple of years. In total Patardzeuli produced around 100 mmbbls before the collapse of the Soviet Union, with all production coming from unsophisticated vertical wells, drilled without the benefit of modern techniques and seismic. Logic dictates, therefore, that there are likely to be substantial volumes remaining at Patardzeuli with the right re-development approach. Internally, Block has quantified these remaining volumes at between 105 mmbbls and 320 mmbbls (1C-3C), with a 2C case of 201 mmbbls.

Since acquiring the asset from Schlumberger in 2019, Block has identified around 50 wells with potential for re-entry and sidetrack, with a view to draining the voids left between production wells. Because they are re-entries, drilling costs are expected to be modest, and well paybacks fast. Accordingly, after a few successful wells the infill drilling campaign could quickly become self-funding, with Patardzeuli effectively becoming a second development hub within Block's portfolio alongside West Rustavi. While group production is still modest, Block's focus is on Project I development drilling (i.e. the West Rustavi/Krtsanisi field). However as cash flow builds, we expect Block to start to allocate capital towards Project II development drilling.

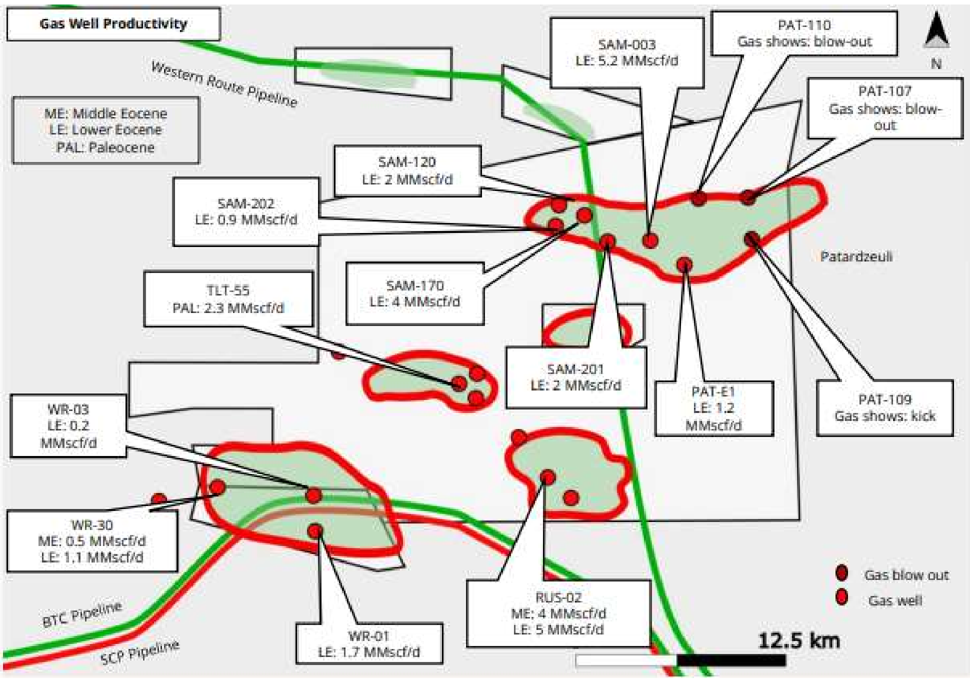
Project III – Lower Eocene and deeper gas appraisal: Underlying Block's existing oil production from Middle Eocene reservoirs in Projects I & II is a significant gas resource contained within Lower Eocene and Upper Cretaceous deposits. The gas is present across permits XIF & XIB and has been confirmed by c. 40 gas tests during the Soviet period as well as more modern tests in the early 2000s and the 2019 PAT-E1 test by Schlumberger.

Gas has been tested in each of the fields, often at high rates, but only limited production (in the Samgori field as part of a Soviet era gas lift project) has been established. The reservoirs are thick and extensive, with reservoirs being c.1km in thickness within some of the accumulations. Block has been working on the gas potential of the licence for several years, primarily through subsurface studies and seismic reinterpretation, and currently carries 860 BCF 2C contingent resources in the West Rustavi/Krtsanisi accumulation and the Patardzueli/Samgori accumulation. An independent CPR by RISC Advisory has now been commissioned which will provide independent validation and economic value of three identified gas fields across XIF & XIB (West Rustavi-Krtsanisi-Rustavi / Patardzueli-Samgori / Teleti).

We expect the CPR to be fundamental to a farm out process, which is likely formally commence following the publishing of the report. A farm out would provide industry validation, as well as an injection of capital to accelerate Project III operations. Block, having inherited a significant amount of Schlumberger work on the Project III gas (including a conceptual field development plan) believes that, as with Project I, the key to unlocking the gas resource will be to undertake horizontal drilling into highly fractured parts of the reservoir.

Monetization of the gas resource will take place via a tie-in to the SOCAR/BP owned South Caucuses pipeline which currently exporting gas from Azerbaijan to Turkey and onward to Europe.

Figure 3: Legacy gas wells blocks XIB and XIF



Source: Block Energy

Project IV – Deep gas exploration: There is also a potentially large deeper exploration play covering a significant portion of Block's acreage. Last year, Block signed a farm out agreement with local operator Georgia Oil & Gas (GOGL). This deal saw GOGL acquire a 50% stake in a portion of Block's exploration acreage in return for US$3m of geological and geophysical studies on the deep gas potential, including new 2D seismic. The Company is currently progressing this project along with GOGL and we would expect an update on progress in due course.

Cash flow forecasts and valuation – Our production profiles assume six new wells are phased onstream over the course of the next two years. At an assumed average cost of US$2m per well, these are comfortably funded through field cash flow. Our individual well profiles assume average oil production of c.170 bopd in year one, declining relatively sharply over the first couple of years before levelling out into the tail.

The result, as illustrated in our financial summary in Figure 4, is that we forecast in the region of US$5m of operating cash flow this year, on EBITDA margins of around US$24/boe. A substantial portion of operating costs are fixed (we estimate corporate overheads of US$3m, equivalent to around 50% of total cash costs), meaning that the forecast incremental increases in production levels will disproportionally improve netback margins. Accordingly, at the end of the six well program we have production peaking in 2025 at 1,089 boepd, generating US$11m of EBITDA on margins of US$27.6/boe (net to Block's 75% entitlement interest and based on oil prices of US$79.5/bbl and a realized gas price of US$4/mcf).

At Block's current share price of 1.05p/shr, the company is being valued on an enterprise value of just US$9m (using our FYE23 estimate of net cash). Our FY23 forecast estimate EBITDA for the year of US$5.1m therefore places the company on a FY23 EV/EBITDA multiple of 1.8x. This multiple falls to 1.5x next year, as production builds to 653 boepd and EBITDA to US$6m, before going below 1x in 2025.

The current share price, in our minds, undervalues Block's prevailing production and cash flow levels, and clearly ignores any value for future growth. Our target price of 4.0p/shr, set at our

Core NAV is conservatively based on the existing producing reserve base only, and even our risked Total NAV of 18.4p/shr includes no value for contingent resources, or exploration opportunities. Once the company is in a position to include firm plans for appraisal and exploration activity (financed by cash flow, farm-out etc.) these can be added to our valuation and target price, potentially triggering significant upgrades.

Figure #: Financial summary

FYE 31ST DEC		2022	2023	2024	2025	2026
Oil production	bopd	330	458	506	844	807
Gas production	mmscf/d	0.9	0.8	0.9	1.5	1.4
Total production	**boepd**	**450**	**591**	**653**	**1,089**	**1,042**
Entitlement interest	%	75%	75%	75%	75%	75%
Average realised price	US$/boe	79.09	67.22	67.45	63.50	60.74
Revenue	**US$m**	8.3	**10.9**	**12.1**	**18.9**	**17.3**
Operating costs	US$m	(4.0)	(2.7)	(3.0)	(4.9)	(4.7)
Unit opex	*US$/boe*	*(24.3)*	*(12.7)*	*(12.6)*	*(12.4)*	*(12.4)*
G&A costs	US$m	(3.0)	(3.0)	(3.0)	(3.0)	(3.0)
EBITDA	**US$m**	1.2	**5.1**	**6.0**	**11.0**	**9.6**
EBITDA margin	*US$/boe*	*7.5*	*23.6*	*25.2*	*27.6*	*25.2*
DD&A	US$m	(2.0)	(2.6)	(2.8)	(4.7)	(4.5)
Profit before tax	**US$m**	(1.6)	**2.5**	**3.2**	**6.2**	**5.0**
Income tax	US$m	-	-	-	-	-
Net income	**US$m**	(1.6)	**2.5**	**3.2**	**6.2**	**5.0**
Adjusted EPS (fully diluted)	*c/shr*	-	*0.22*	*0.27*	*0.54*	*0.44*
Profit before tax	**US$m**	(1.6)	**2.5**	**3.2**	**6.2**	**5.0**
Cash flow reconciliation	US$m	3.1	2.6	2.8	4.7	4.5
Tax paid	US$m	-	-	-	-	-
Net operating cash flow	**US$m**	1.5	**5.1**	**6.0**	**11.0**	**9.6**
Cash flow margin	*US$/boe*	*12.7*	*30.5*	*32.5*	*35.6*	*32.5*
Capex	US$m	(2.4)	(5.0)	(6.0)	(6.0)	-
Free cash flow	**US$m**	(0.9)	**0.1**	**0.0**	**5.0**	**9.6**
Movement of debt	US$m	-	2.0	-	-	-
Net increase (decrease) in cash	**US$m**	(0.9)	**2.1**	**0.0**	**5.0**	**9.6**
Net cash (debt)		0.5	0.6	0.6	5.5	15.1
Forecast EV	*US$m*	*9.0*	*8.9*	*8.9*	*4.0*	*(5.6)*
P/E – fully diluted	*x*	-	*4.7x*	*3.8x*	*1.9x*	*2.4x*
EV/EBITDA	*x*	-	*1.8x*	*1.5x*	*0.4x*	*(0.6x)*

Source: Tennyson Securities.

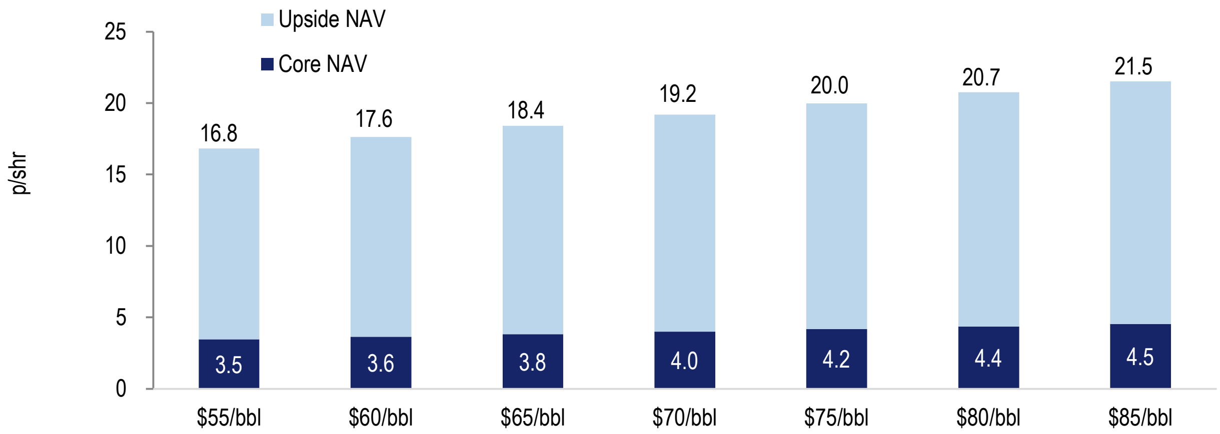
Figure #: Valuation table

NET ASSET VALUE							
Asset	Net mmboe	US$/boe	Unrisked US$m	p/share	CoS	Risked US$m	p/share
3P reserves (W. Rustavi)	3.4	14.4	48.4	4.3	100%	48.4	4.3
Add: net debt – YE23			0.6	0.0		0.6	0.0
Add: option proceeds			2.8	0.3		2.8	0.3
Deduct: G&A (3yr)			(9.0)	(0.8)		(9.0)	(0.8)
Core NAV	**3.4**		**42.7**	**3.8**		**42.7**	**3.8**
Upside (Block XIB 2P only)	60.6	10.8	653.3	58.4	25%	163.3	14.6
Total NAV	**64.0**		**696.0**	**62.2**		**206.1**	**18.4**

Valuation assumptions:
Brent: US$83.1/bbl FY23, US$83.3/bbl FY23, US$78.6/bbl FY24, US$75.1/bbl FY25 and US$65/bbl flat thereafter.
Domestic gas price: US$4/mcf flat.
Discount rate 10%.
1.26 US dollar / sterling.
724.7 basic shares, plus 163.8m dilutive options & warrants = 888.5m fully diluted.

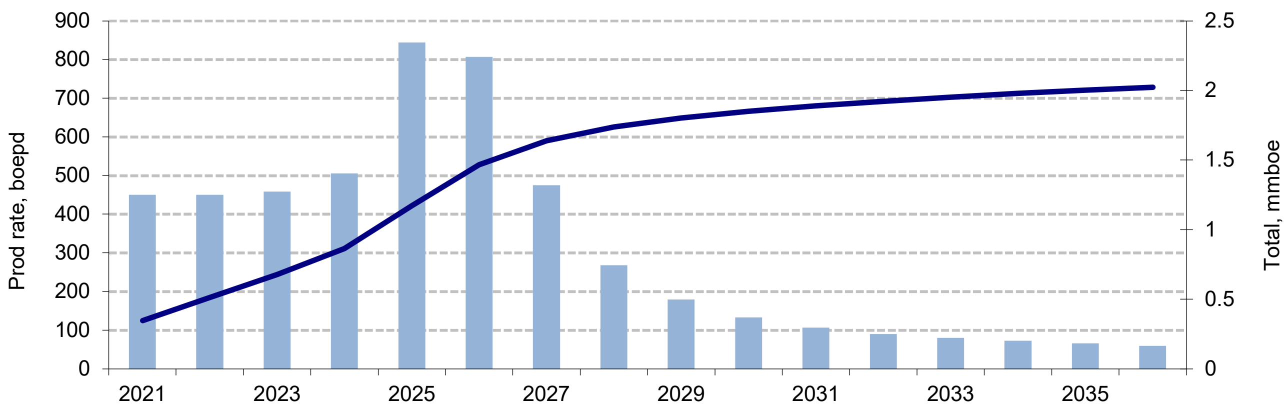
Source: Tennyson Securities.

Figure #: Sensitivity table – Core and Upside NAV at various long term oil price assumptions (2027 onwards)



Source: Tennyson Securities.

Figure #: Tennyson production profile (annual and cumulative)



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Market index : FTSE AIM ENERGY

Date	Market Index level	Share Price (p)	Target Price (p)	Opinion
18 Oct 2023	703.86	1.05	4.0	BUY

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