Simba Energy

Kenya CPR results

Edison investment research

Kenya focus intensifies

Oil & Gas

Simba's investor focus is likely to centre firmly on Kenya for the foreseeable future. The recent Block 2A CPR has booked the company's first prospective resources while corporate deal flow in the region and most significantly the eagerly anticipated drill results from the Tullow operated Ngamia-1 well could make Kenya the next hot address in Africa. Valuations remain highly speculative, but 60c a share could be realistic in the event that prospectivity in the Mandera-Lugh basin is proven and Simba can move its Kenya assets through to being drill ready.

Year end	Revenue (C$m)	EBITDA (C$m)	PBT* (C$m)	Debt (C$m)	Net cash (debt) (C$m)	Capex (C$m)
06/10	0.0	(1.4)	(1.4)	0.0	0.5	(0.7)
06/11	0.0	(6.1)	(4.9)	0.0	1.5	(0.2)
06/12e	0.0	(3.6)	(3.7)	0.0	6.2	(2.3)
06/13e	0.0	(2.3)	(2.1)	0.0	2.7	(1.3)

Note: *PBT is normalised, excluding intangible amortisation and exceptional items.

CPR confirms first prospective resources

Despite the availability of only limited and poor-quality 2D seismic data, independent consultant Sproule has estimated 27mmboe of risked and 445mmboe of unrisked prospective resources from three leads in Block 2A where Simba has a 100% interest. The company is set to start a passive seismic programme in July 2012 that should help prove up resources ahead of a likely 2D seismic campaign and drill programme.

Accelerating in-country activity

Timing for the CPR and passive seismic campaign could hardly have been better, with investor focus clearly on Kenya at the moment. Leading this is the Ngamia-1 well being drilled by Tullow Oil where preliminary well results have been highly encouraging. Afren is shooting seismic in Block 1 while partner Lion Petroleum provides corporate newsflow with its ongoing reverse takeover into TSX-V listed Taipan Resources.

Simba remains a portfolio play

Although Kenya is clearly the current focus the company continues to build a pan-Africa portfolio that could lead to more resources being identified. Guinea is the most active address with a recent agreement to acquire interests in Blocks 1 and 2, while Liberia interest is likely to grow with Chevron's first well offshore currently being drilled.

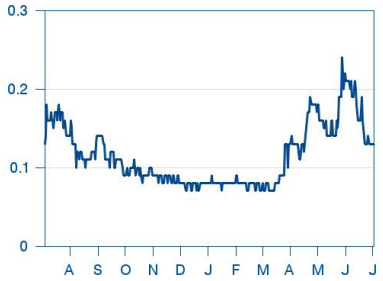
Valuation: Deal flow could reset expectations

Simba's early mover strategy means valuations are obviously speculative in nature, although with Kenya now the key valuation driver we can envisage a range of valuations based on different scenarios. Using this approach our valuations range up to 202c per share with 60c a reasonable outcome in the event that prospectivity of the Mandera-Lugh basin is proven and Simba can move its assets through to being drill ready. If Ngamia-1 is declared commercial we see significant potential for major deal-flow in Kenya, which could rapidly escalate the value of Simba's acreage.

3 July 2012

Price	C$0.13
Market cap	C$29m
	C$1.0/US$
Shares in issue	226.4m
Free float	96%
Code	SMB
Primary exchange	TSX-V
Other exchanges	N/A

Share price performance



%	1m	3m	12m
Abs	(34.2)	(3.6)	3.9
Rel (local)	(38.6)	43.7	18.1
52-week high/low		C$0.24	C$0.07

Business description

Simba Energy is a pan-African oil and gas company focused on onshore projects. It holds a PSC contract for Block 2A in Kenya and has a 60% interest in a PSC for Block 1 and 2 onshore Guinea. It is planning to expand into Liberia, Mali and Ghana.

Next events

Pass seismic shoot	July 2012
Ngamia-1 results	July 2012
Pass seismic result	September 2012
Block 1 seismic	End 2012

Analysts

Ian McLelland +44(0)20 3077 5756

Will Forbes +44(0)20 3077 5749

oilandgas@edisoninvestmentresearch.co.uk

Edison profile page

Simba Energy is a research client of Edison Investment Research Limited

Kenya activity gathers pace

Simba's strategy has seen it build an expansive pan-African asset portfolio across numerous onshore frontier areas. Although the company's early positions have been in West Africa, including Liberia, Guinea, Mali and Ghana, much of its recent operational focus has been in East Africa and in particular Kenya. Through a combination of Simba's own activities, exploration and drilling activity in nearby blocks and ongoing and potential corporate deal-flow we expect Kenya to become a major focus of attention for investors in the coming months and years. With an established in-country presence as operator of Block 2A, Simba is well placed to benefit from potential newsflow alongside established independents such as Tullow Oil, Afren and Africa Oil.

CPR confirms resource potential

The Sproule Associates Limited (Sproule) resource assessment of Block 2A Kenya as announced in June 2012 marks an important milestone for Simba confirming its first independently assessed prospective resources. Although risked prospective resources at this stage only amount to 26.9mmboe from three leads across Block 2A (Exhibit 1) the fact that these have been derived from generally poor historic 2D seismic and from only two historic wells, neither of which penetrated the new target horizons, can give the company and investors confidence there is more to come. Larger prospects in neighbouring blocks, both north and south of Block 2A, indicate the general prospectivity of the basin, while newsflow in the region is likely to remain high with Tullow/Africa Oil reporting positive results from their ongoing Ngamia-1 well in the west of the country, which could be Kenya's first commercial discovery.

Exhibit 1: Block 2A prospective resources

		Gross unrisked undiscovered petroleum initially in place (mmboe)				Gross unrisked prospective resources (mmboe)					Gross risked mean prospective resources (mmboe)
Lead	Zones	Mean	Low estimate P90	Best estimate P50	High estimate P10	Mean	Low estimate P90	Best estimate P50	High estimate P10	Geological CoS (%)	Mean
1	Ken 5	507.2	61.3	279.4	1186.6	117.2	11	55.8	272.6	9	10.5
	Syn-Rift 2	413.5	48.5	224.4	969.7	95.5	8.73	45.1	221.8	4	3.8
	Syn-Rift 1	326.4	27.4	152.7	778.2	75.4	4.98	30.5	181.3	2	1.5
2	Ken 5	180.9	21.9	99.7	423.3	41.8	3.94	19.9	97.3	9	3.8
	Syn-Rift 2	128.7	11.6	62	306.8	29.8	2.09	12.4	71.3	4	1.2
	Syn-Rift 1	98.3	14.6	59.3	219.9	22.7	2.57	11.8	53.2	2	0.5
3	Ken 5	272.1	41.5	165.5	615.8	62.9	7.32	32.9	146.4	9	5.7
Total		1927.1				445.3					26.9

Source: Simba Energy, Sproule

Neighbouring blocks point to resource upside

Block 2A lies immediately to the North of Lion Petroleum's Block 2B, where 127.1mmboe of risked prospective resources (386.7mmboe un-risked) have been identified on block by independent consultant Sproule. Block 2B is an important comparator for Simba as it straddles the relatively underexplored Mandera-Lugh basin to the north and the greater explored Anza basin to the north-west. Block 2A sits at the juncture of the Mandera-Lugh and Anza basins with resources to date identified from play types in the Mandera-Lugh basin.

Lion Petroleum is planning to start drilling on Block 2B in H113. The company is preparing to reverse into TSX-V listed Taipan Resources Ltd and with access to additional capital from a public listing we would expect to see significant newsflow during H212 around preparations for drilling on Block 2B.

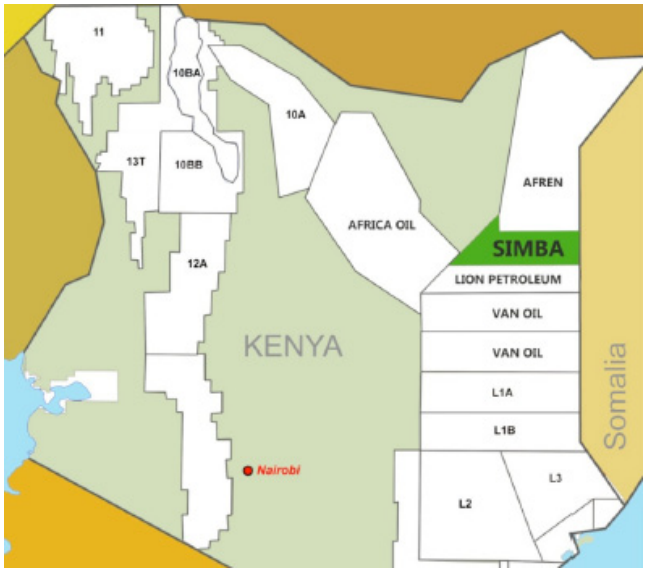
North of Block 2A is the significantly larger Block 1 that covers most of the Mandera-Lugh basin. Block 1 is operated by Afren with Lion Petroleum as partner. In March 2012 Afren announced it had started shooting 1,800km of 2D seismic over Block 1 targeting an internal estimated 751mmboe of unrisked prospective resources, which should complete by end 2012. This campaign is equally important for Simba given its Block 2A prospects are from the same Mandera-Lugh basin as covered by Block 1.

Passive seismic set to de-risk Block 2A resources

Simba's Block 2A lacks quality seismic at present and this is the main reason for the heavily risked and consequently low prospective resources awarded by Sproule (an average 6% geological chance of success having been applied to the three leads). Furthermore, although two wells have been drilled previously on Block 2A (the Elgal-1 and 2 wells drilled by Amoco in 1987) neither of these went as deep as the Jurassic, Triassic and Permian horizons identified by Sproule in its resource update and hence little can be observed from the historic well logs.

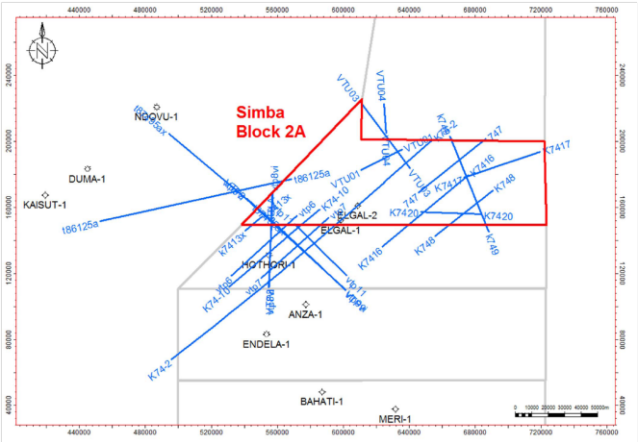
What we do know is that Sproule has indicated 445.3mmboe of mean un-risked prospective resources across the three leads in Block 2A from petroleum initially in place of 1.9 billion barrels. With this impressive resource potential, Simba is pressing on with E&A activities on the block with a 218 measuring point passive seismic campaign that will cover 750 km^2. This campaign has been delayed in recent months due to poor weather conditions although we understand the shoot is now set to begin in early July 2012 with 30 days required to capture the data and a further 60 days for processing.

Exhibit 2: Kenya blocks



Source: Simba Energy

Exhibit 3: Historical 2D and wells



Source: Sproule

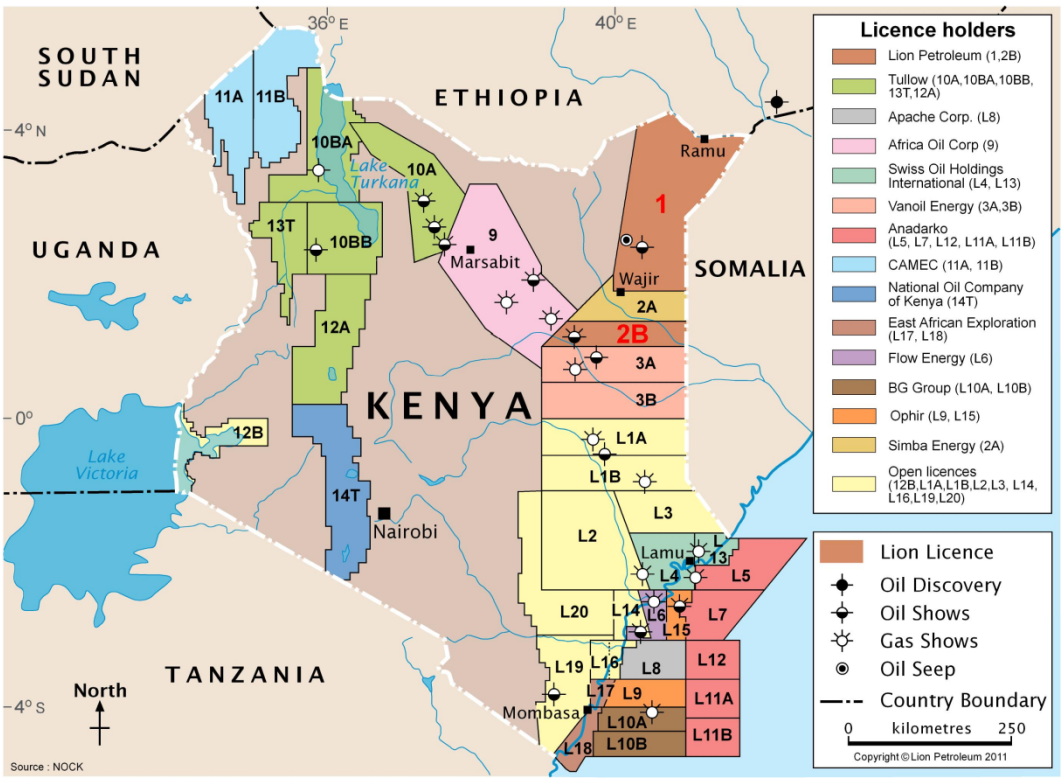
We would expect the current passive seismic work, when integrated with existing and reprocessed 2D, to better define the prospectivity of the block. At this point Simba would be in a strong position to seek a farm out and we see this as a key catalyst over the next six to 12 months.

Ultimately we would expect Simba plus any partner to acquire 2D or 3D seismic over select targets on Block 2A before drilling. All the identified leads have four-way closures so the company estimates two to four 2D seismic lines per prospect would be sufficient to be drill ready.

Kenya: Big names bringing it to the fore

Kenya is greatly underexplored with only 28 onshore exploration wells drilled to date. As recently as 2005 the country only had six blocks licensed with only two companies actively operating. However, licensing has stepped up in recent years with big name entrants including Tullow Oil, Africa Oil, Ophir, BG and Afren among an enviable list of exploration companies now operating in the country (Exhibit 4).

Exhibit 4: Kenya licences



Source: Lion Petroleum

The take up of licences in recent years has certainly helped bring investor focus to the region. However, until very recently the story has been around prospectivity rather than commerciality. This looks set to change with two of the most prolific independent explorers in Africa, Tullow Oil and Africa Oil, reporting highly promising results from their Ngamia-1 well currently drilling to TD in Block 10BB while seismic has recently been shot in Blocks 10BA, 10A, 1, 3A and 3B. Following the Ngamia-1 well Tullow will drill the Twiga-1 well on the neighbouring Block 13T.

Only preliminary, albeit highly promising, drill results have been announced to date by Tullow for Ngamia-1, but if a commercial discovery were to be declared we would expect this to be a significant boost to investor interest in the area and in particular to Simba given its leveraged exposure to Kenya.

Simba portfolio continues to grow

In addition to Kenya, Simba continues to grow its portfolio across Guinea, Liberia, Mali and Ghana:

- Guinea: Following a review of available technical data, the company signed an agreement in May 2012 to acquire a 60% interest in the PSA for Blocks 1 and 2 comprising 12,000km^2 onshore in the Republic of Guinea's Bove basin. We expect a work programme, including shooting seismic, to proceed once final approval from the Minister of Mines is received.
- Liberia: Liberia was Simba's first African project with it receiving the country's first onshore reconnaissance licence in January 2009. To date, a 125km^2 seeps survey has indicated a large number of seeps. Newsflow in the near term is likely to be driven by offshore operations with both Africa Petroleum and Anadarko having already drilled wells that have identified good quality reservoir and in the case of Africa Petroleum the presence of oil shows. Chevron is believed to have begun drilling its first well offshore Liberia in late April 2012 and positive news from this would open up interest from a new investor base.
- Mali: Simba has secured a PSA on Block 3 that was previously evaluated by ENI with good quality 2D seismic and hydrocarbon shows from previous wells. However, political and regional sensitivities are high in the country at present and we understanding Simba is unlikely to progress activities here until there is more stability.
- Ghana: This is the earliest stage of all Simba's assets with the company having applied for a PSC in the Voltaian Basin for a total of 8,700km^2.

Valuation

Not surprisingly it is difficult to quantify a value for Simba's portfolio of assets given their generally early stage.

The most advanced of the company's assets is Block 2A in Kenya. As Block 2A covers the same Mandera-Lugh basin as Block 1 it is possible to infer a value for Block 2A based on the farm-in terms of Afren for Block 1. Afren is contributing $6m to carry Lion through 600km of 2D seismic for a 50% interest and with an option to increase this to 80% if a further 600km of 2D is shot for $6m. This equates to $0.016/bbl of un-risked resources for 50% or $0.02/bbl for 80%. We can therefore infer a base valuation for Block 2A's 445mmboe of un-risked resources of $7-9m, although given that Lion Petroleum's farm-out was partially a distressed deal this valuation could be considered as conservative.

With the possibility of increasing interest in Kenya following the Ngamia-1 well it is possible Simba could command a higher valuation for its Block 2A assets if there are further discoveries in the country and Simba can move its assets through to being drill ready. In this case, we could apply a nominal $5/bbl based on analogues such as Tullow's consideration for Heritage Oil's discovered but undeveloped P50 reserves in Uganda. Multiplying this netback to the risked prospective resources (to account for pre-drill geological uncertainties) in Block 2A would suggest a risked NAV for Block 2A of $135m. This could increase further if the upcoming passive seismic campaign de-risks the block and increases the geological chance of success as estimated by Sproule.

Finally, in the event of early appraisal success the valuation for Block 2A would rise significantly. Given Simba's limited access to capital we would suggest that actual drill activity (with each well estimated to be $7-10m) would require a farm-out. Based on a nominal 50% farm-out with a two well carry this could infer a success case valuation after initial drilling of $458m.

Based on these three scenarios we propose a valuation range of between 4c and 202c per share, with 60c as a valuation in the event that prospectivity for the Mandera-Lugh basin is proven and Simba moves its Block 2A assets through to being drill ready.

Exhibit 5: Valuation range

		$m	share
Valuation 1	Valuation inferred by Block 1 farm-in terms only	9	4
Valuation 2	Pre-drill valuation if basin prospectivity is proven	135	60
Valuation 3	Unrisked valuation if early appraisal 2A drilling successful	458	202

Source: Edison Investment Research

Our numbers do not currently ascribe any value to Simba's remaining acreage in Guinea, Liberia, Mali and Ghana. We would expect to include these in due course once PSCs are secured and evaluation work programmes are firmed up that will lead to drill activity.

Financials: Farm-out expected to accelerate work programme

We consider Simba is funded for approximately the next 12 months work programme. Current cash is estimated at around $6m reflecting a $4.242m private placement in April 2012 along with warrants exercised since this time. The current passive seismic programme is expected to cost $1.2m including both the survey and interpretation, while a geochemical survey being performed on Block 2A at the same time as the passive seismic will cost an additional $0.1m.

In the event of other discoveries in Kenya and encouraging results from the Block 1 2D seismic programme or drilling in Block 2B in H113 we would expect Simba to accelerate its Block 2A work programme. The current PSC includes a commitment to shoot 1,000km of 2D in the additional exploration periods of the Block 2A PSC costing $10-12m. To fund this and initial exploration/ appraisal wells we would expect Simba to be seeking a farm-in partner for its Block 2A operations once results of the ongoing passive seismic programme have been interpreted.

Edison investment research

Exhibit 6: Financial summary

CAD'000s	2010	2011	2012e	2013e
Year end 30 June	CANGAAP	CANGAAP	IFRS	IFRS
PROFIT & LOSS				
Revenue	0	0	0	0
Cost of Sales	0	0	0	0
Gross Profit	0	0	0	0
EBITDA	(1,366)	(6,083)	(3,643)	(2,254)
Operating Profit (before amort and except)	(1,356)	(4,852)	(3,653)	(2,264)
Intangible Amortisation	0	0	0	0
Exceptionals	0	0	0	0
Other	0	0	(8)	0
Operating Profit	(1,356)	(4,852)	(3,661)	(2,264)
Net Interest	(69)	(5)	1	123
Profit Before Tax (norm)	(1,425)	(4,857)	(3,652)	(2,142)
Profit Before Tax (FRS 3)	(1,425)	(4,857)	(3,660)	(2,142)
Tax	0	0	0	0
Profit After Tax (norm)	(1,425)	(4,857)	(3,660)	(2,142)
Profit After Tax (FRS 3)	(1,425)	(4,857)	(3,660)	(2,142)
Average Number of Shares Outstanding (m)	47.6	110.1	162.0	226.4
EPS - normalised (c)	(3.0)	(4.4)	(2.3)	(0.9)
EPS - normalised fully diluted (c)	(3.0)	(4.4)	(2.3)	(0.9)
EPS - (IFRS) (c)	(3.0)	(4.4)	(2.3)	(0.9)
Dividend per share (p)	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A
Operating Margin (before GW and except) (%)	N/A	N/A	N/A	N/A
BALANCE SHEET				
Fixed Assets	1,979	2,087	4,373	5,698
Intangible Assets	1,968	1,968	4,240	5,551
Tangible Assets	10	119	133	148
Investments	0	0	0	0
Current Assets	551	1,644	6,289	2,858
Stocks	0	0	0	0
Debtors	10	55	37	38
Cash	533	1,516	6,171	2,739
Other	9	73	81	81
Current Liabilities	(589)	(473)	(889)	(925)
Creditors	(589)	(473)	(889)	(925)
Short term borrowings	0	0	0	0
Long Term Liabilities	(80)	(20)	(88)	(88)
Long term borrowings	(17)	(17)	(17)	(17)
Other long term liabilities	(62)	(2)	(70)	(70)
Net Assets	1,861	3,239	9,686	7,544
CASH FLOW				
Operating Cash Flow	(1,324)	(3,782)	(3,209)	(2,219)
Net Interest	(69)	(5)	1	123
Tax	0	0	0	0
Capex	(660)	(230)	(2,296)	(1,335)
Acquisitions/disposals	0	0	0	0
Financing	2,877	4,999	10,159	0
Dividends	0	0	0	0
Net Cash Flow	823	983	4,655	(3,432)
Opening net debt/(cash)	308	(516)	(1,499)	(6,154)
HP finance leases initiated	0	0	0	0
Other	0	0	0	0
Closing net debt/(cash)	(516)	(1,499)	(6,154)	(2,722)

Source: Edison Investment Research, company accounts

Registered in England, number 4794244. Edison Investment Research is authorised and regulated by the Financial Services Authority.
www.edisoninvestmentresearch.co.uk

London +44 (0)20 3077 5700
Lincoln House, 296-302 High Holborn
London, WC1V 7JH, UK

New York +1 212 551 1118
380 Lexington Avenue, Suite 1724
NY 10168, New York, US

Sydney +61 (0)2 9258 1162
Level 33, Australia Square, 264 George St,
Sydney, NSW 2000, Australia