Pura Vida Energy

Energy Research

19 December 2014

BUY

Bloomberg	PVD LN
Price (A$/shr)	0.36
Target Price (A$/shr)	1.04
Upside (%)	193%
12mth high/low (A$/shr)	0.65 / 0.29
Shares out (mill)	130.1
Fully diluted (mill)	163.2
Mkt Cap (US$m)	40.5
Enterprise Value (US$m)	24.0

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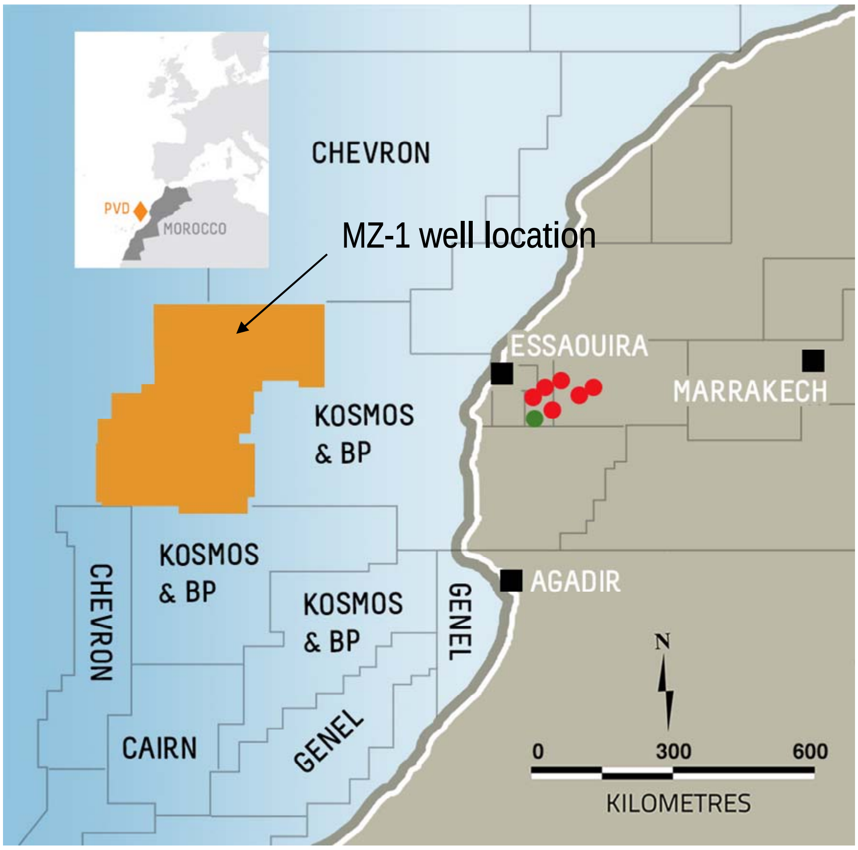
Moroccan delight

Pura Vida (PVD) has announced a new location for its first well in the Mazagan permit offshore Morocco, electing to drill a deeper, more costly hole on the Ouanoukrim prospect – a series of independently risked stacked targets, with 1.4bn bbls of prospective resources (385 mmbbls net). The decision, taken with partner Freeport McMoRan, is driven by a desire to drill the basin's entire prospective stratigraphic section and test multiple independent play types with the first well, which appears to us to be a logical approach in a frontier exploration province such as this. Alongside the change in well location, PVD has also amended its 2013 farm-out deal with Freeport which gives PVD the option to sell down additional equity to protest against cost overruns. With drilling set to kick off in March, and Freeport reasserting its commitment to the project, we maintain our BUY recommendation with an unchanged target price of A$1.04/shr.

Figure 1: Mazagan permit and MZ-1 well location, offshore Morocco



Source: Pura Vida Energy.

Revised well location

Following an extensive technical review (incorporating reprocessed 3D data), the Mazagan partners have elected to change the location of the first well on the licence from the Toubkal prospect to the Ouanoukrim prospect. While the news comes only a few months from drilling, we understand that the new well location has been the preferred option for some time, subject to formal sign off from the partnership and Government. Ouanoukrim is located in the north of the permit (see Figure 1, above) at the limit of the existing 3D seismic coverage and comprises four stacked structural and stratigraphic traps in the Cenomanian, Aptian and Lower Jurassic. The proposed well (MZ-1) will be drilled to a depth of 5,600m (TVDSS) with the potential to deepen the hole to 6,150m to penetrate a fifth objective in the Lower Jurassic. As shown in Figure 2, below, PVD estimates mean prospective resources of 1.4 bn bbls (328 mmbbls net) with upside to over 3bn bbls (707 mmbbls net).

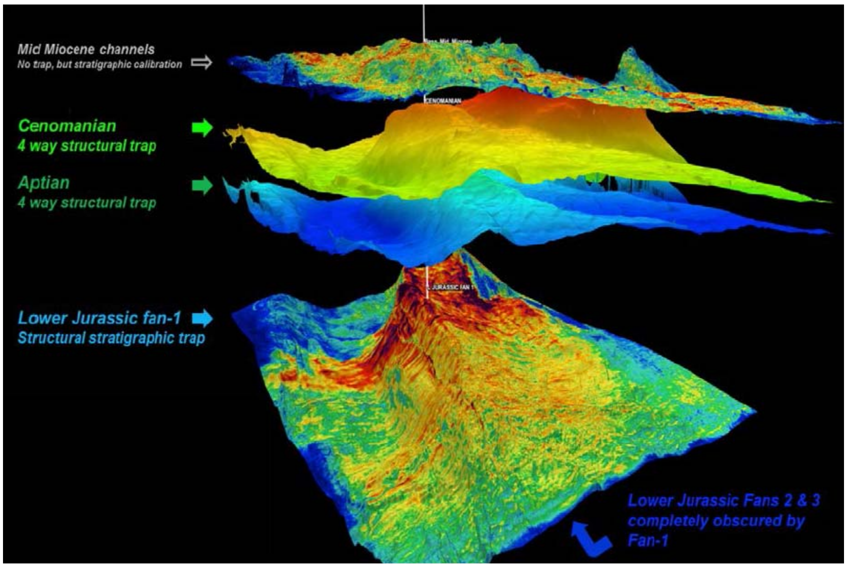
Figure 2: Pura Vida resource estimates for the Ouanoukrim prospect

Ouanoukrim Prospective Interval	Gross Prospective Resources Unrisked (mmbo) [1,2]				Gross Prospective Resources risked (mmbo) [1,2]		Net Prospective Resources (mmbo)[1,2]
	Low	Best	High	Mean	POS	Mean Risked	Mean Unrisked
Cenomanian	9	39	95	47	23%	11	11
Aptian	42	238	680	309	30%	94	71
Lower Jurassic – Fan 1	84	450	1,290	588	13%	76	135
Lower Jurassic – Fan 2	21	79	189	95	12%	11	22
Lower Jurassic – Fan 3	60	306	820	385	12%	45	89
Total Recoverable prospective resources (aggregated, mmbo)[3]	**216**	**1,112**	**3,074**	**1,424**		**237**	**328**

Source: Pura Vida. Pura Vida Energy. [1]Probabilistic estimation at 17 Dec 2014. [2]POS refers to probability of success. [3]Arithmetic summation of probabilistic estimates.

The rationale for switching the well site centres on two main factors. Firstly, as depicted in Figure 3 below, the MZ-1 location allows for the testing of up to five targets with independent geological risks, providing a better overall chance of success. Conversely, the Toubkal prospect is a single, shallow target in the Mid-Miocene (at a depth of 1,000m). Secondly, the deeper MZ-1 well will test the entire prospective stratigraphic section providing a better understanding of the basin and where to locate the second well. Indeed, MZ-1 is expected to drill through the same Mid-Miocene channel sands targeted at Toubkal (out of closure) yielding valuable data that will be used to calibrate the 3D seismic response over the Toubkal structure (which in our base case is drilled second after the results of Ouanoukrim are known).

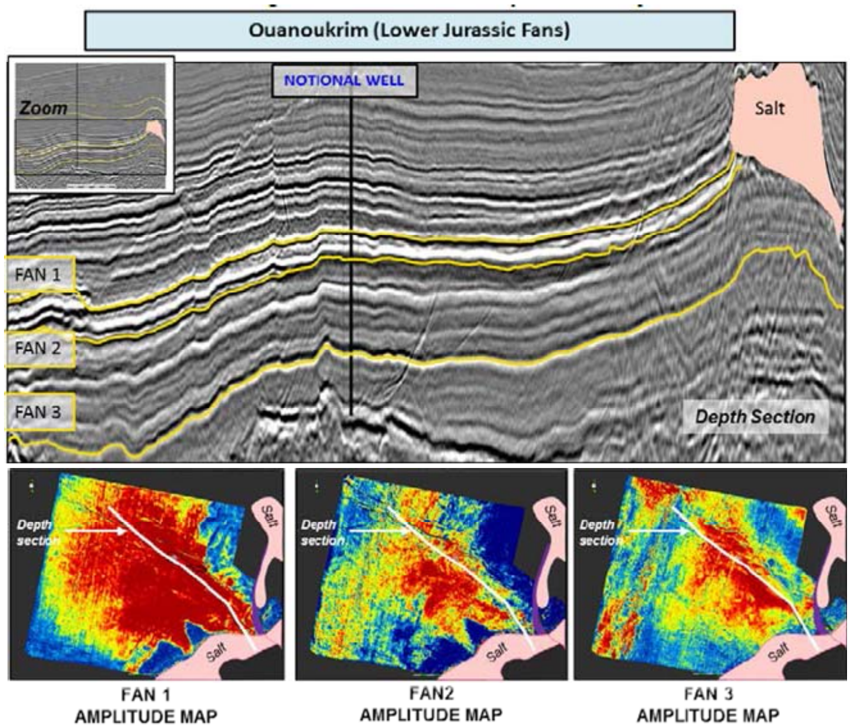
Figure 3: Ouanoukrim prospect 3D seismic image and MZ-1 well location



Source: Pura Vida Energy.

The primary target of the MZ-1 well is the Lower Jurassic section where three basin floor fans have been mapped with gross resource potential of 1.1bn bbls (75% of the total). As Figure 4 shows, below, each of these fans exhibits a clear seismic amplitude response with an apparent feeder channel acting as the conduit for the sands (although we note there is no well calibration to confirm that the seismic response indicates sand presence). In terms of charge, the prognosed Jurassic source rock is expected to be interbedded within the fans providing a low risk migration pathway (the source rock is tied back to the prospect from a nearby DSDP well on 2D seismic). The key geological risk is the integrity of the up-dip seal which is reliant on a pinch out against the salt and truncation by major faults which may not seal. That said, the smaller 4 way dip closures could still work (see roll-over penetrated by the 'notional well' in Figure 4, below) and, in any event, a breached trap would improve the chances of the overlying salt cored anticlines in the Cretaceous being charged. In assessing the geological risks, PVD has ascribed a 12-13% chance of success to the Lower Jurassic fans and a more modest 23-30% chance of success to the two Cretaceous targets, which possess less trap risk by virtue of being structural closures.

Figure 4: Ouanoukrim prospect, Lower Jurassic 3D seismic image



Source: Pura Vida Energy.

In terms of the drilling schedule, the Attwood Achiever drillship is expected to spud the Al Khayr-1 well for Kosmos offshore Western Sahara by the year end and the vessel will likely arrive in the Mazagan permit in March (slightly later than management's previous guidance of January). Due to the depth of the MZ-1 well, drilling is expected to take 60-90 days (versus 35 days for Toubkal), implying a result at the middle/end of Q2. Subsequently, the drillship will move to drill two wells for third parties before returning to Mazagan towards the end of H2. The location of PVD's second well will be confirmed once the results from MZ-1 are known with a number of candidates under consideration, including Toubkal.

Freeport farm-out tweaked

In tandem with the change of well location, PVD has announced a modification to the 2013 farm-out agreement with Freeport in which PVD divested 52% of the Mazagan permit for a gross carry on two wells up to a cap of US$215m (leaving PVD with a residual stake of 23%). Under the amended terms, PVD has obtained an option to sell additional equity to Freeport on effectively the same terms to protect the company against potential cost overruns above the US$215m cap. The rationale for this is the additional cost of drilling the MZ-1 well which is budgeted at US$137m (including 10% contingency and a 20% allowance for rig downtime), compared to US$60m for the much shallower Toubkal well. If PVD elects to exercise the option (which it can do at any point prior to the drilling of the second well) its interest in Mazagan will be diluted by 1% for every US$4.5m of gross well costs above the US$215m cap, provided that PVD's equity interest in the licence is interest is not diluted below 4%. In the event that the 4% floor is reached, Freeport carries all additional costs with no dilution.

The option agreement is clearly an important event for PVD as it removes the risk associated with drilling cost overruns which can prove disastrous for small cap E&Ps. Moreover, we believe that it serves to reinforce Freeport's appetite for the block. Taken as a whole, the US group has: (1) committed to drill a much more expensive first well, and (2) agreed to underwrite PVD's share of any overruns. Given the fall in oil prices and broader pressure on capital budgets we view this as a major positive.

Valuation update and funding

We have adjusted our valuation to reflect PVD's revised drilling plans, assuming that Ouanoukrim is drilled first and Toubkal second. For the former, we have relied on PVD's mean prospective resource estimations (1,428 mmbbls gross) and risking (17% weighted average CoS for the five horizons) while the latter assumes the figures in the 2012 D&M resource report as before (the Ouanoukrim prospect was not covered in D&M's 2012 analysis). The outcome is a revised Total NAV for the company of A$15.95/shr, comprising A$5.38/shr for Ouanoukrim, A$10.39/shr for Toubkal and the balance for cash and option proceeds. This compares to our previous NAV of A$11.29/shr which assumed 2.0bn bbls of targeted resources versus 2.9bn bbls now.

As a side point, our NAV assumes a value per barrel in the ground of US$13.84/bbl using a long run Brent price of US$90/bbl flat nominal and a discount rate of 10%. We would note that the breakeven oil price in our model is ~US$35/bbl (assuming a 10% discount rate), reflecting the projects robust economics at much lower oil prices.

Figure 5: Company valuation table

10% NPV; US$90/bbl L-T	Gross[1]		Net[1]		Unrisked			Risked	
Asset	mmboe	Interest	mmboe	US$/boe	US$m	p/shr	CoS[2]	US$m	p/shr
Ouanoukrim (1st well)	1,424	23.0%	328	13.84	4,532	31.66	17%	770	5.38
Toubkal (2nd well)	1,507	23.0%	347	13.84	4,796	33.50	31%	1,487	10.39
Add: options & warrants					16	0.12		16	0.12
Add: cash					9	0.06		9	0.06
Total NAV	**2,931**		**674**		**9,353**	**65.34**		**2,283**	**15.95**

Source: Mirabaud Securities estimates. [1]D&M & PVD recoverable mean prospective resources. [2]D&M & PVD estimated geological chance of success.

The key attraction of Pura Vida is the scale of the upside in Morocco which is a function of (1) the size of the drilling targets, (2) the inferred geological chance of success, and (3) the fact that it has retained a healthy 23% working interest post farm-out. We estimate that the two well drilling campaign offers investors exposure to a staggering A$65/shr of unrisked value, or more than 180x the current share price. That said, our target price continues to be set at the implied value of the Freeport deal, plus cash and Gabon/Madagascar entry costs, the sum of which is A$1.04/shr.

From a funding perspective, Pura Vida is well positioned with US$16m of cash (no debt) as of end September. This should see the company through the next 9-12 months with the potential for cash to be augmented by any farm-out deal in Gabon (talks are ongoing with a view to finalise a deal before the drilling of the MZ-1 well in March). Looking ahead, the largest single capex item (excluding carried drilling costs) is the planned 3D seismic in Madagascar (~US$9m) which has been delayed by environment permitting and may end up costing less in the prevailing environment.

RECOMMENDATIONS HISTORY

Market index ASX Small-Cap Resources

Date	Market Index level	Share Price (A$)	Target Price (A$)	Opinion
23 Jun 2014	3,629.1	0.46	1.04	BUY
19 Dec 2014	2,415.1	0.355	1.04	BUY

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BUY: The stock is expected to generate absolute positive price performance of over 20% during the next 12 months.

ACCUMULATE: The stock is expected to generate absolute positive price performance of 10-20% during the next 12 months

NEUTRAL: The stock is expected to generate absolute price performance of between 10% positive and 10% negative during the next 12 months.

REDUCE: The stock is expected to generate absolute negative price performance of 10-20% during the next 12 months

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