Bowleven

Operating update

Operating update and shareholder activism

Oil & gas

December and January have seen the emergence of shareholder activism at Bowleven (BLVN), bringing its strategy and management into greater focus. Its largest shareholder (Crown Ocean Capital, COC) evolved from being a supportive shareholder to voting against a number of resolutions at the December AGM, to recently calling for the widespread removal of the board and a radically different company structure. Operationally, the company reports that a new development concept is under review by the stakeholders in Etinde, where production would be piped to existing gas processing facilities in Equatorial Guinea. Such a solution would (if approved) require significantly less capex and could be brought online relatively quickly vs other solutions (fertiliser, FLNG, gas to power). We leave our valuation largely unchanged, save for a revision to cash holding to reflect the recent operational update. Our new core NAV is 49p/share.

Year end	Revenue ($m)	PBT* ($m)	Operating cash flow ($m)	Capex ($m)	Net (debt)/ cash ($m)
06/15	0.0	(14.1)	(10.4)	(35.1)	144.8
06/16	0.0	(7.0)	(6.9)	(48.2)	88.0
06/17e	0.0	(9.0)	(9.9)	(7.5)	86.1
06/18e	6.1	(5.0)	(3.5)	(42.0)	66.0

Note: *PBT is adjusted, excluding exceptional items and share-based payments.

COC calls for changes

On 24 January, COC called for the removal of the majority of the board, the return of excess cash, cessation of work on Bomono and repositioning of BLVN as a holding company to concentrate on Etinde, rejecting any strategy of acquisitions that has hitherto been sought. These resolutions will be put to a general meeting, and the company expects to issue a response before the general meeting (GM).

Laudable intentions, but more questionable actions

While COC's stated intentions of raising the share price are laudable, many of the actions it calls for are already in place or are counter to the long-term health of the company. All shareholders would like to see the shares starting to reflect the latent value in Etinde, but it is not clear how the proposed changes would make a material difference to the existing work that management is carrying out, including the two appraisal wells (net $40m carry) at Etinde and progressing the development concept (for which NewAge is taking the lead as operator). Meanwhile, Bowleven is making good progress with reducing the G&A (by 23% so far) and it is right to retain operational capability as an active partner in Cameroon.

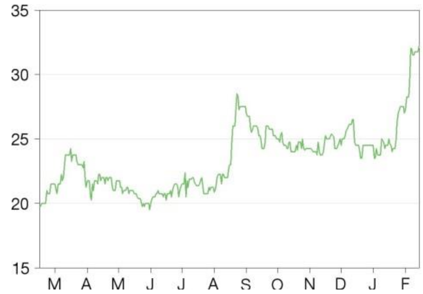
Valuation: Tweaked to 49p/share

We leave our valuation broadly unchanged, given that these developments do not immediately affect the company's main assets or operations. Our core NAV moves to 49p/share, including the company's $95m cash (as of December) and its 20% working interest in the Etinde project. Drilling of the appraisal wells is dependent on the development concept chosen by the JV, with early monetisation prioritised over future spend. The opportunity remains to target material upside.

15 February 2017

Price	**24.50p**
Market cap	**£78m**
	US$/£0.8
Net cash ($m) at 31 December 2016	95
Shares in issue	328m
Free float	93%
Code	BLVN
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	31.6	34.4	67.5
Rel (local)	32.1	24.8	32.5
52-week high/low		32.2p	19.5p

Business description

Bowleven is an AIM-listed, Africa-focused E&P with assets in Cameroon. Its main asset is its 20% net interest in the Etinde development, which holds 290mmboe of 2C contingent resource.

Next events

Etinde development concept agreement	2017
Appraisal wells	2017

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Edison profile page

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Operational update

On 26 January, Bowleven released an operational update, which is summarised below:

- Discussions (led by NewAge, the operator) continue on the Etinde development concept. The company specifically mentioned FLNG and gas-to-power together with a possible new avenue of processing the production in Equatorial Guinea. This is a particularly promising solution if it were to be selected. The possibility of using existing infrastructure and equipment only 34km from Etinde that has been designed for very similar hydrocarbon types means that significantly less capex may be required to monetise the asset (increasing NPV) and probably reduce time to first oil/gas. Given the presence of existing offtake infrastructure, this option has less project-on-project risk than the other options, so technically it should provide far fewer problems. It should be noted that a cross-border solution would require resolution of a number of political questions, which are unlikely to be simple (taxes, fees, transfer prices).

  The fertiliser solution (which we use as our default development concept in lieu of further information) was not mentioned, but remains an option.

  Timing has not been given for appraisal wells, targeting unrisked GIIP of up to 2tcf at the P90 level. This is tied to negotiations with the government over the development concept, with the wells not immediately required for an early development solution (enough resource already exists for one offtake solution). We continue to assume the two wells are drilled in 2017 and that the costs are completely carried by the $40m net carry due to BLVN. Should the wells not be required for early development, Bowleven can claim the cash equivalent of the carry, payable in early 2020.
- On Bomono, formal resolution over a two-year extension has been signed, confirming the state's support for the two-year extension of the Bomono exploration licence and a Provisional Exploitation Authorisation (PEA). Bowleven is in advanced discussions over a farm-out of the asset. Any deal is expected to expedite early cashflows to the company while limiting capex exposure. Successful completion of the deal should lead to the company's first revenue stream, partially offsetting the G&A expenses.
- Evaluation of over 50 possible targets has been undertaken, with no acquisitions made. In our view, this thoroughness makes it more likely that an acquisition (if made) will be attractive.
- Bowleven has made strides in reducing its G&A, resulting in a 23% fall in admin expenses. This includes staff redundancies, director pay cuts and a move to a smaller office.

Crown Ocean Capital proposals

COC's proposals and our comments are summarised below.

Exhibit 1: COC proposals and Edison comments

COC comments (January 2017)	Comments
Return excess cash to shareholders.	COC has not indicated what it regards as excess cash levels. Bowleven held $95m in cash as of December 2016. The development concept for Etinde has not been decided and the final design may well require material funding that is close to or exceeds Bowleven's current cash position. The forward curve and funding in the oil & gas sector implies that little RBL facility may be available before first oil/gas and as such any material cash returns in the short term may be more than cancelled out by possible equity issues further down the line to obtain this funding. Management had already put in place a modest buyback programme to return a limited amount of cash in a tax efficient manner. COC's vote at the AGM blocked this programme from continuing.
Create an alignment of stakeholders in the Etinde project (Etinde), Bowleven's most valuable asset.	It is not clear how the suggested restructuring would improve this alignment.
Identify the route to value maximisation from Etinde over time.	Bowleven is an active partner with the operator, but no longer has control over the concept and negotiations with the government. A restructuring would not affect this position.
Citing material shareholder value destruction over many years, cease further spending on the Bomono project and conduct an independent review of the estimated $100m spent at Bomono to date.	Oil exploration is by definition a risky and capital-intensive business and oil investors should be aware that exploration will often see failures resulting in losses. It is disappointing that the company has seen this money invested with no clear return as yet. Failures at Sapele, delays with the Etinde project and cost over-runs at Bomono are extremely unfortunate, but these are features of oil development. However, this does not mean that a return cannot be made from further investment in Bomono, if this produces positive returns. The company is currently in arbitration over the drilling spend at Moambe and Zingana at Bomono.
Wholescale changes to the board required to counter:	
- High G&A.	Bowleven is reducing G&A and has achieved 23% reductions so far, including cutting personnel and moving to smaller premises.
- Historically high cash outflows with no resulting production.	Nature of oil business implies some losses over time. The scale of losses is regrettable for investors, but this should not mean throwing out the baby with the bathwater.
- Board plan to acquire cash generating assets instead of cutting costs.	With a flat forward curve and still some assets available, it is entirely possible that Bowleven may make accretive deals as others remain in difficulty. The management has shown caution by not progressing with the Tanzanian acquisition and, according to the operational update, over 50 targets have been evaluated with no bid, suggesting prudence and thoroughness.
Proposal to remove the entire board (except David Clarkson), and add two new directors (see bios below).	The outcome of COC's proposed board changes, if effected would be to leave Bowleven with a board of three (two COC appointees and David Clarkson). This creates significant challenges to effective corporate governance of the company and few (if any) safeguards for minority shareholders given COC's (assumed) control over two thirds of its proposed board. As the biographies below indicate, it is not clear that either of the proposed new board members has the necessary experience to run Bowleven and no experience/relationships in Cameroon.
Critical of management due to reduction of equity in Etinde to 20%.	Within the oil industry, funding has to be gained, and this will require material reduction in holdings for E&Ps with no in-house cash flows. As a comparison, Rockhopper has seen its stake in Sea Lion fall materially since discovery, while Tullow (which has production) now has a fully carried development in Uganda, but holds only 10%. These are just two of many, many examples that we could cite – including how supermajors like BP and Exxon reduce stakes for funding and risk management purposes.
New directors proposed by COC	
Eli Chahin (senior advisor to Alix Partners, a management consultancy). On board of the Al Jaber Group, a privately owned conglomerate.	Consulting with an oil and gas company is different from running one, and we would look for further confirmation of Mr Chahin's experience before making a judgement on his suitability to help Bowleven shareholders see value.
Chris Ashworth (various legal roles, including partner at Ashurst, partner at Lovells and General Counsel at Knight Vinke).	No indicated oil experience.

Source: COC, Edison Investment Research

Up until the investment at Bowleven, COC was an investor in early-stage technology companies, a far cry from activist oil investment. With such little expertise in oil companies, it is not clear that the proposed new structure and management are capable of running Bowleven in the long term and helping it realise the material latent value in Etinde.

We also note that in the last three months, COC's position on its support for the board and company strategy has moved materially, leading to questions about whether it could move again. We summarise the actions taken before Christmas below.

(Pre-) AGM update

COC has increased its stake in Bowleven from below the 3% level at the beginning of 2016 to 15% now, becoming its largest shareholder in the process (now holding 49.8m shares). On 15 November, it tabled additional resolutions for discussion at the AGM, proposing the election of three new directors (at the expense of three existing NEDs), its first public statement on the company.

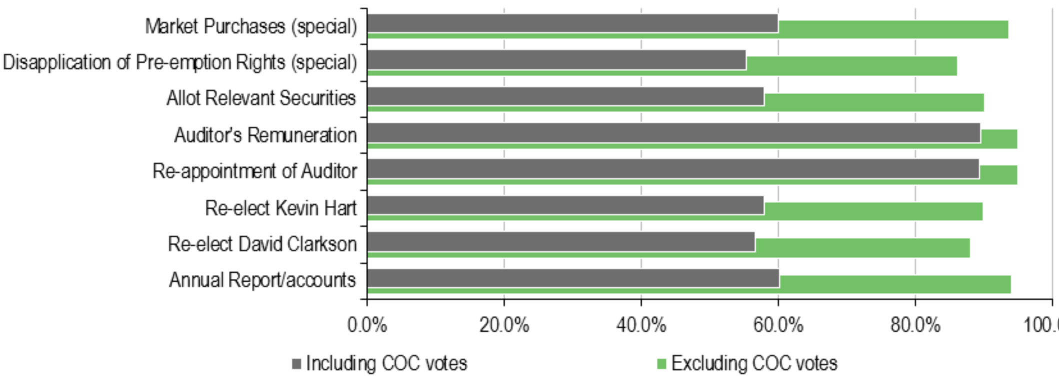
The requisition not accepted by BLVN for the AGM (held on 14 December), as both resolutions were defective under the Companies Act. At the time, BLVN reported that COC "expressed their confidence in the Chairman and the executive management of the Company and no requisitions have been made with regard to the Executive Directors of the Company".

In November, BLVN stated its confidence in the experience and expertise of the three NEDs, which COC had proposed replacing, all of whom have spent many years working in the industry, either on the financial/banking side (John Martin) or operations and management (Tim Sullivan and Philip Tracy). Brief descriptions of the directors at that time proposed by COC (Breht McConville, Titus Gebel and Matthew Eugene McDonald) revealed very little (including no oil and gas experience).

Actions taken at the December 2016 AGM

As none of the COC resolutions were put for vote, the AGM had votes on the resolutions put forward by BLVN. COC voted against all eight of the resolutions (although it did not use all of its voting rights to vote against the re-election of the auditor or its remuneration). In particular, COC used its 42,539,208 votes to vote against the re-election of Kevin Hart (CEO) and David Clarkson (COO), as well as against (the standard resolutions) to adopt the annual accounts. Finally, it voted against authorising the directors to allot up to one-third of the share capital as deemed necessary. The net result was that all the ordinary resolutions were passed, but the two special resolutions (requiring 75% of the vote) were not. A summary of the vote is given below. All resolutions would have passed without COC's votes.

Exhibit 2: Summary of results of AGM vote



Source: Bowleven

This was clearly a yet another change of stance from COC – from seeking an MBO to stating its confidence in the executive in November to voting against the CEO/COO and against management's freedom to allot shares to now supporting.

COC seems to have changed its position again – to support David Clarkson but stand against the rest of the executive and board.

Valuation

We leave our valuation broadly unchanged, barring a tweak to cash levels reflecting the recent operational update. Our core NAV is 49p/share. We stress that the two appraisal wells (which are carried to a net level of $40m) if drilled in 2017, could add very materially to the resource base of Etinde, and Bowleven.

Alternatively, we would point to the string of delays in the appraisal wells as an indication of possible future delays in FID and our current modelled first oil date of 2022. We also stress that (pending resolution of the concept negotiations) our modelling is currently based on a fertiliser solution, which be different to the final agreed solution in terms of costs and NPV. For example, an Equatorial Guinea development would likely be able to start before 2022 with lower capex and therefore likely higher NPV.

Exhibit 3: NAV summary

Asset	US$/£0.8 No. shares: 328m		Recoverable reserves			Net risked value				
	Diluted WI	CoS	Gross	Net	NPV/ boe	@12.5% DR		DR sensitivity		
	%	%	mmboe		$/boe	$m	p/share	10%	15%	20%
Net (debt)/cash at Dec 2016	100%	100%				95	23	23	23	23
G&A NPV of three years (includes share payments)	100%	100%				(19)	(5)	(5)	(5)	(5)
$25m on FID (assumed early 2018)	100%	83%				21	5	5	5	5
Buyback programme (up to a maximum of c $10m for up to 48.5m shares)	100%	100%				0	0	0	0	0
Development								0	0	0
Etinde development	20%	50%	181	36	5.9	106	26	35	19	11
Core NAV						**203**	**49**	**59**	**43**	**34**
Potential development								0	0	0
CLNG extension	20%	20%	109	22	6.8	29	7	7	7	7
Bomono - Moambe small-scale gas project	90%	50%	11	10	7.7	39	9	11	8	7
Possible development								0	0	0
Bomono - Zingana Power Supply	90%	10%	27	24	2.1	5	1	2	1	0
Cost of cash shortfall for development	100%	10%				(3)	(1)	(1)	(1)	(1)
Possible exploration NAV						71	17	20	15	13
RENAV						**273**	**67**	**78**	**58**	**48**

Source: Edison Investment Research

Exhibit 4: Financial summary

US$'000s	2013	2014	2015	2016	2017e	2018e
Year end 30 June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
Revenue	0	0	0	0	0	6,124
Cost of Sales	0	0	0	0	0	(3,285)
Gross Profit	0	0	0	0	0	2,839
EBITDA	(10,592)	(11,604)	(11,471)	(20,246)	(8,800)	(4,776)
Operating Profit (before GW and except.)	(11,088)	(12,025)	(11,868)	(20,901)	(9,440)	(5,416)
Exceptionals	0	0	(75,959)	(122,305)	15,000	25,000
Goodwill and intangible amortisation	0	0	0	0	0	0
Operating Profit	(11,088)	(12,025)	(87,827)	(143,206)	5,560	19,584
Net foreign exchange gain/(loss)	0	0	0	0	0	0
Net Interest	7	(1,577)	(2,192)	13,937	457	407
Profit Before Tax (norm)	(11,081)	(13,602)	(14,060)	(6,964)	(8,983)	(5,009)
Profit Before Tax (FRS 3)	(11,081)	(13,602)	(90,019)	(129,269)	6,017	19,991
Tax	0	0	0	0	0	0
Profit After Tax (norm)	(11,081)	(13,602)	(14,060)	(6,964)	(8,983)	(5,009)
Profit After Tax (FRS 3)	(11,081)	(13,602)	(90,019)	(129,269)	6,017	19,991
Average Number of Shares Outstanding (m)	295	324.3	324.3	325.0	328.0	328.0
EPS - normalised (c)	(3.8)	(4.2)	(4.3)	(2.1)	(2.7)	(1.5)
EPS - FRS 3 (c)	(3.8)	(4.2)	(27.8)	(39.8)	1.8	6.1
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	N/A	N/A
BALANCE SHEET						
Fixed Assets	533,437	551,446	306,558	214,522	221,382	258,775
Intangible Assets	532,507	550,745	304,662	213,669	214,529	218,322
Tangible Assets	930	701	1,896	853	6,853	40,453
Investments	0	0	0	0	0	0
Current Assets	52,150	42,351	212,029	149,819	149,810	129,701
Stocks	11,023	10,404	5,370	3,650	4,000	4,000
Debtors	16,385	6,493	6,431	2,955	4,500	4,500
Cash	19,742	20,454	144,751	88,026	86,122	66,013
Other receivables	5,000	5,000	55,477	55,188	55,188	55,188
Current Liabilities	(15,568)	(6,274)	(12,695)	(2,366)	(2,000)	(2,000)
Creditors	(15,568)	(6,274)	(12,695)	(2,366)	(2,000)	(2,000)
Short term borrowings	0	0	0	0	0	0
Long Term Liabilities	0	0	0	0	0	0
Long term borrowings	0	0	0	0	0	0
Other long term liabilities	0	0	0	0	0	0
Net Assets	570,019	587,523	505,892	361,975	369,192	386,476
CASH FLOW						
Operating Cash Flow	(8,404)	(8,576)	(10,438)	(6,941)	(9,861)	(3,516)
Net Interest	556	177	139	450	457	407
Tax	0	0	0	0	0	0
Capex	(114,381)	(18,037)	(35,141)	(48,171)	(7,500)	(42,000)
Acquisitions/disposals	0	0	160,688	0	0	0
Financing	76	20,924	71	(186)	0	0
Other	0	4,482	9,016	0	15,000	25,000
Net Cash Flow	(122,153)	(1,030)	124,335	(54,848)	(1,904)	(20,109)
Opening net debt/(cash)	(142,481)	(19,742)	(20,454)	(144,751)	(88,026)	(86,122)
Effect of FX changes	(586)	1,742	(38)	(1,877)	0	0
Other	0	0	0	0	0	(0)
Closing net debt/(cash)	(19,742)	(20,454)	(144,751)	(88,026)	(86,122)	(66,013)

Source: Edison Investment Research, company accounts

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