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Andalas Energy and Power plc*

3 September 2018

BUY

Stock Data

Share Price:	0.98p
Market cap.:	£2.9m
Shares in issue:	296.2m
Fully diluted equity:	329.7m

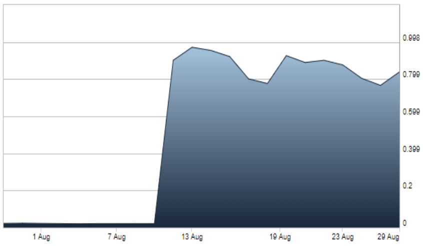
Company Profile

Sector:	Oil & Gas
Exchange:	AIM
Ticker:	ADL

Activities

Andalas is an oil and gas company focused on development projects in Sumatra, Indonesia complemented by exploration upside in the UK Southern North Sea.

Performance data (1 month)



Directors

Robert Arnott:	Chairman
Simon Gorringe:	CEO
Dan Jorgensen:	Finance. Director
Ross Warner:	Legal & Commercial
Graham Smith:	Non-Exec. Director

Important Notice

*Optiva Securities acts as joint broker to Andalas Energy and Power plc.

Conditional acquisition of Indonesian oil project

Andalas has entered into a conditional agreement to acquire an initial 25% participating interest in the onshore Bunga Mas PSC (Production Sharing Contract) in South Sumatra, Indonesia which contains the Bunga Mawar oil field. Completion is subject to several factors including an extension of the PSC's exploration period. However, we believe that this asset is particularly attractive given the significant prospective resource upside associated with numerous additional structures on the licence and the potentially large historical expenditure pool associated with the licence, the recovery of even a proportion would significantly enhance the economics of a development project

Andalas has conditionally agreed to acquire 25% of the Bunga Mas PSC with the associated rights to increase this interest to 49% and ultimately 100%. The consideration is very modest, consisting of 19.2 million Andalas shares of which 9.6 million shares are payable on completion of the acquisition with a further 9.6 million shares payable upon regulatory approval of the increase in the company's interest to 49%.

Although completion is subject to various regulatory conditions including the extension of the exploration period of the PSC, Andalas has agreed to undertake new exploration and development within the PSC as an exclusive operation entitling the company to 100% of the cash flow under the PSC terms.

Under the terms of the deal, Andalas has agreed to acquire 100% of Aura Violet International (AVI) from Tilegarre Corporation. AVI is the parent company of PT Bunga Mas Energi (BME) which has a 25% interest in the PSC. The other interests in the PSC are held by Bunga Mas International Company (BMIC: 51%) and Dorato Fiore Pacifico (DFP: 24%). BMIC is currently the operator of the PSC and each of AVI, BMIC and DFP are subsidiaries of Arctic Bay Ventures Inc. (ABV). (See next page for additional details of the agreement).

Within the PSC, the core asset is the Bunga Mawar field, estimated to contain 2C contingent oil resources of 0.22 mmbbls and best estimate prospective resources of 2.09 mmbbls in the Air Benkat formation. Andalas expects that initial work on the PSC will involve testing the Bunga Mawar field to convert prospective resources to contingent resources thereby formulating the basis of a longer term multi-well development plan.

The project's economics are enhanced considerably by previous expenditures on the PSC totalling US$111.7m of which a proportion is expected to represent a recoverable cost pool attributed to the Bunga Mawar field. Like the terms of the extension to the exploration period, we understand that the level of recoverable costs will also be subject to regulatory approval.

There is appreciable resource upside in terms of several additional structures containing significant oil and gas upside on the PSC. In particular, the Melati structure is estimated to contain 2C contingent gas resources of 26 BCF and there is estimated to be a further 54.5 mmbbls of prospective resources contained within five additional structures on the licence. Andalas notes that these structures possess GCoSs ranging from 15% to 30%.

Assuming that Andalas concludes successfully the acquisition of Bunga Mas, we expect that the company will focus its efforts on bringing the Bunga Mawar field into production through a multi-well drilling programme. Even in the event that less than a fifth of the previous expenditure on the field is available as a recoverable cost pool, we believe that the economics and early years' cash flow from a development project indicate rapid payback of early stage drilling costs and solid long term cash flow to the company.

Indicative valuation for Andalas

At this comparatively early stage, we have calculated an indicative risked valuation for Andalas' asset portfolio of US$23m. Within this, we have ascribed an initial value of $4.4m (NPV 10) for a 25% interest in the Bunga Mawar field which would rise to US$17.5m assuming the company acquired the full 100% interest. We recognise that Andalas already has 100% economic control of Bunga Mas; however, we have elected to be conservative at this stage.

With the application of a conservative unit NPV per boe and appropriate risk factors, we have also ascribed a sum of the parts valuation of US$13.8m to Andalas' initial 25% in the prospective resources identified within six additional fields on the wider Bunga Mas PSC. Assuming that Andalas increases its interest in the Bunga Mas PSC, this valuation could be as much as US$55.2m.

We have also ascribed a raft of technical and commercial risk factors to Andalas' indirect interest in the Eagle Gas prospect inventory to generate an indicative valuation of US$4.8m for the company's indirect interests in a prospect inventory of six potential drilling targets. At this stage, we are being particular conservative and we acknowledge that there is substantial upside within this portfolio of assets, particularly in the event that Eagle Gas can secure farm-inees on Licence P2112 in the UK Southern North Sea.

It is also pertinent to note that the company's interest in Eagle Gas is structured as an investment and therefore Andalas is not exposed to any future funding commitments. Although, as in the case of such investments, Andalas' holding is subject to potential dilution in the event that the company does not participate in any future Eagle Gas fund raisings.

Potential funding requirements

We understand that Andalas has a current cash position of approximately £0.7m. Nevertheless, a longer term work programme on Andalas' portfolio is largely unfunded and in the case of Bunga Mawar, the company would need to raise additional capital to commence a multi-well drilling programme in order to expedite a full development of the field. However, with the instigation of early cash flow, the project has the potential to be self-funding after the onset of production from initial wells and cash flow from Bunga Mawar also has the potential to fund a significant proportion of future drilling activity on other prospective structures on the PSC in later years.

Additional details of the transaction

As outlined previously, Andalas has agreed to issue 19.2 million new shares in two equal tranches to secure an initial 25% interest in the Bunga Mas PSC. The first tranche of 9.6 million shares will be allotted on receipt of the approval of SKK Migas and the Government of Indonesia with regards to the transfer by Dorato Fiore Pacifico (DFP) for its participating 24% interest to PT Bunga Mas Energi (BME).

The sale and purchase agreement which has a longstop date of 31 December 2018 is conditional upon:

1. DFP agreeing to assign its 24% interest to BME for US$1.00 and submission to SKK Migas of an application to approve the transfer.
2. The Indonesian Minister of Energy and Mineral Resources approving an extension to the exploration period of the PSC acceptable to Andalas.
3. Various parties including the Arctic Bay Group entering into a further Framework Agreement to regulate the activities of BMIC, DFP and BME under the joint operating agreement (JOA).
4. Other procedural matters necessary to complete the transaction

The company notes that BMIC will initially continue to be the operator of the PSC although Andalas has the right to require BMIC to withdraw from the PSC and transfer its participating interest to BME (already acquired by Andalas) for US$1.00. At this stage, BME would seek to be the new operator.

If BME has not commenced its exclusive operations within seven months after Completion of the agreement, Arctic Bay may sell BMIC to a third party and permit it to undertake exclusive operations on the PSC.

Prior to Andalas executing the sale and purchase agreement, each of BMIC, DFP and BME granted a royalty in favour of Arctic where each company agrees to pay:

1. 20% of the proceeds, net of tax, from the sale of that portion of production allocated to the participating interest owners for the recovery of costs (“Cost Hydrocarbons”) incurred in relation to the development of the Mawar formation until such time as the aggregate proceeds distributed to participating interest owners is $19.7m or such other sum as SKK Migas permits for the recovery of the costs incurred to date in relation to that project; and
2. 5% of the proceeds, net of tax, from the sale of all hydrocarbons allocated to the participating interest owners other than Cost Hydrocarbons (“Profit Hydrocarbons”).

Andalas has granted Arctic Bay an option to purchase a 20% participating interest in the PSC. The consideration payable on exercise of the option is the termination of the Royalty and a cash sum equal to all amounts paid to Arctic Bay pursuant to the Royalty. The option may only be exercised after completion of the sale and purchase agreement and DFP transferring its participating interest to BME provided that notice is given before 30 June 2020.

In addition, Arctic has granted Andalas an option to purchase each of BMIC and DFP for US$1.00 each and an option to put AVI back to Arctic for US$1.00.

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