SacOil Holdings

Adverse reaction to announcement

Edison investment research

Ticking along…

Oil and gas

Since 21 August, when SacOil withdrew its cautionary statement concerning a potential acquisition, the share price has fallen 30%, significantly underperforming its Nigerian-focused peer group. The underperformance presents an opportunity to examine the catalysts that could reverse it in coming months.

Year end	Revenue (ZARm)	Gross Profit* (ZARm)	PBT* (ZARm)	Debt (ZARm)	Net cash (debt) (ZARm)	Capex (ZARm)
02/11	35.1	11.5	(27.4)	0.0	17.9	(54.5)
02/12	37.2	10.6	65.6	28.9	(18.2)	(1.0)

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

Share price reaction too strong?

The company has seen around £8m wiped from its market cap since 21 August. We note that within this time, the company has only indicated a postponement of a transaction and that there are a number of potential catalysts which could lead to positive performance within the next six to 12 months.

Work at DRC block is progressing

Total has completed the aeromag survey and the preliminary processing "broadly confirms the trend observed in the adjacent concessions in Uganda". We expect 2D seismic acquisition during the dry season (November-April) and a possible well will follow in late 2013/early 2014. The potential of DRC (Democratic Republic of the Congo) Block III can be inferred from the enthusiasm that Total is showing, after farming-in this year (67% equity). This is not surprising given the success of the proximate Lake Albert discoveries in Uganda. SacOil holds a 12.5% interest and is fully carried until a final investment decision (FID).

Catalysts for Nigeria just round the corner

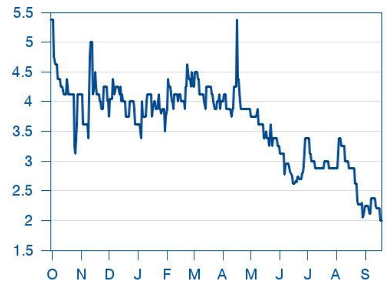
The company owns interests in two Nigerian exploration blocks. While the assets have yet to be drilled, they should represent lower exploration risk than other assets in the prolific Nigerian delta region close to existing producing assets. Q412 should see OBC 3D seismic acquisition in blocks OPL 233, and OPL 281 will have existing 3D seismic data reprocessed. This work (subject to government approvals) should give the company further insight into prospectivity and future well locations, leading to drilling one well in each block in mid-2013. Existing competent persons report (CPR) work has concluded P50 volumes of 19mbbls and 98mbbls in OPL 233 and OPL 281 respectively, with other prospects possible. The company is fully funded for the next six months.

We are updating our model and will publish updated forecasts in due course.

18 September 2012

Price	**2.00p**
Market cap	**£18m**
	ZAR13.2/£
Shares in issue	918.3m
Free float	28%
Code	SAC
Primary exchange	JSE
Other exchanges	AIM

Share price performance



%	1m	3m	12m
Abs	(30.4)	(23.8)	(96.2)
Rel (local)	(31.2)	(29.6)	(96.5)
52-week high/low		5.35p	2.00p

Business description

SacOil is an Africa-focused exploration company with assets in Nigeria and the DRC.

Next events

Title and PSC awarded for Nigerian blocks	Q412

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Corporate summary

SacOil has 20% interest in two Nigerian blocks. OPL 233 is an offshore block, which an independent CPR has estimated to contain 19mboe (2C), and OPL 281 (onshore, 98mboe (2C)). It also has a 12.5% working interest in Block III in the DRC and a non-core holding in a Manganese plant in South Africa.

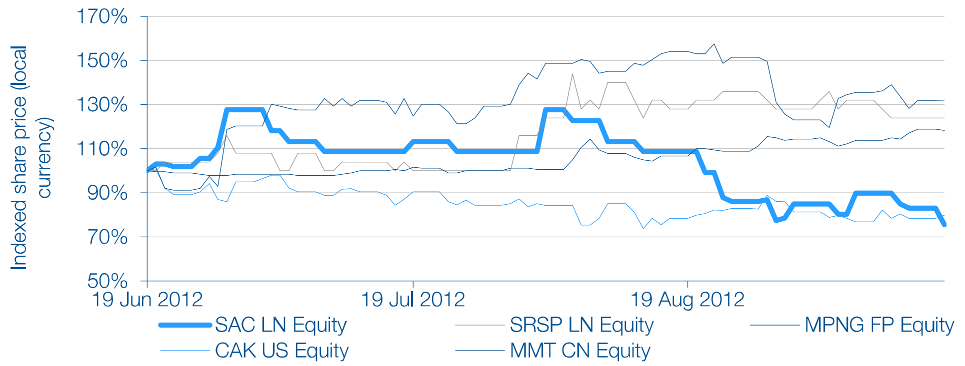
SacOil's year has been outwardly quiet of late, but this is likely to change in 2013. Its two Nigerian blocks, OPL 233 and OPL 281, currently have seismic data being captured and processed and we expect exploration drilling to take place in 2013. In the DRC, the company's interest in Block III is being progressed by the operator, Total. The recent announcement of the completion of the aeromag survey is positive and will lead to acquisition, processing and interpretation of seismic data over the acreage in due course. An exploration well could follow in late 2013, which could turn out to be a transformational year for the company.

We believe the company is fully funded to pay for the work activities in the next year – it still has around $20m of its SEDA capacity available, as well as expected cash from its partner in the Nigerian blocks, Energy Equity Resources (EER). Successful exploration in its blocks will necessitate further cash outlays, but should also lead to an increase in value of the assets.

Recent underperformance vs peers

Exhibit 1 shows that SacOil's share price has underperformed its Nigerian-exposed peers over the last three months. The majority of this underperformance has been since 21 August, when the company announced that it was withdrawing a cautionary statement concerning a possible acquisition. Shares have fallen 30%. While we view it as mildly negative, the disappointment of the postponement of a possible acquisition does not seem to justify the share price action alone.

Exhibit 1: Indexed three-month share price performance for Nigeria-exposed companies



Source: Bloomberg

Company and asset description: Pure-play African explorer

SacOil is a South Africa-based company with interests in two exploration blocks in Nigeria and one in the DRC. In Nigeria, it has partnered with indigenous companies in order to exploit the increasing indigenisation of the Nigerian oil industry, and to acquire acreage as larger companies such as Shell relinquish them. In the DRC, it is partnered with Total on a promising concession close to the Lake Albert discoveries made by Tullow and Heritage in Uganda. It also owns a manganese processing plant, which it considers non-core and is looking to divest.

Exhibit 2: Block OPL 281

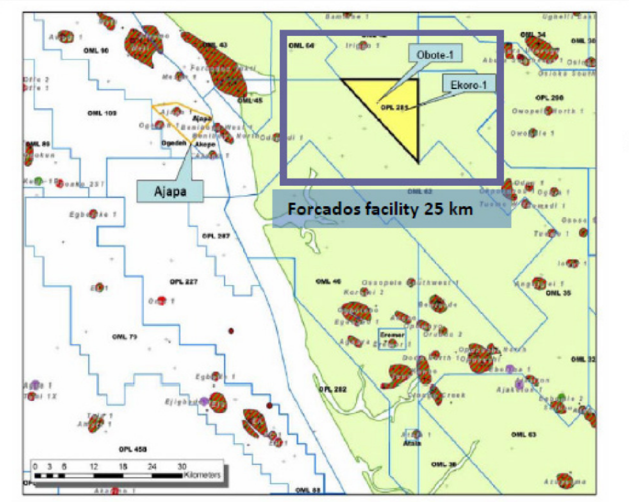
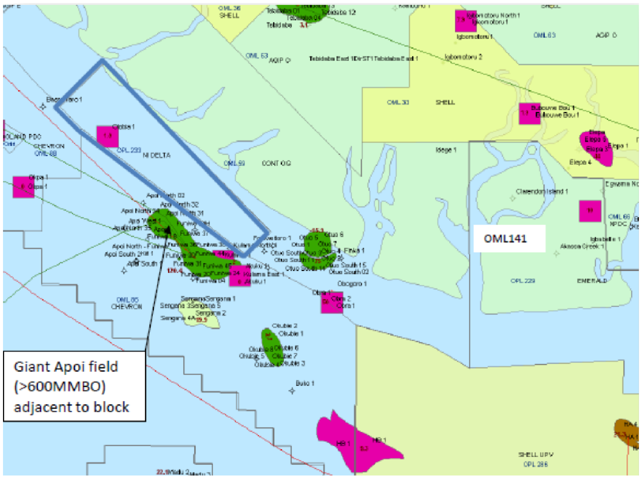


Fig. 2.1: OPL281 Licence and well locations

Source: SacOil

Exhibit 3: Block OPL 233



Source: SacOil

Nigeria – OPL 233 – offshore

Block OPL 233 is a shallow offshore block (water depths less than 10m) with discovered but undeveloped oil and gas assets. The block covers126km² and is 120km from the Forcados terminal. Although a discovery has been made on the concession, there is inadequate seismic coverage of the remaining area.

The existing CPR on the block estimates current 2C best-estimate unrisked contingent resources of 19mbbls, net 2C best-estimate unrisked contingent resources of 3.8mbbls and net 2C best-estimate risked contingent resources of 1.5mbbls (based on a recovery factor of 40%). Given the prolific nature of the Nigerian delta region and the proximity of the concessions to nearby production and existing discoveries[1], the company is optimistic of further commercial discoveries being made in future.

SacOil will fund the majority of the exploration work programmes (one well and 100 km² seismic for first phase and earn a 20% paying working interest and a 30% participation interest falling to 20% once cumulative production exceeds 50mbbls gross).

Work programme

The work programme requires seismic programme and the drilling of one well. However, expenditures will only commence once it receives formal title to the concession, which it expects to gain within the next three months.

[1] Olobia-1 well showed 103ft net oil pay and 54ft gas and condensate in five zones according to TRACS report.

Seismic interpretation of existing seismic data has been completed and award of the 100km^2 3D seismic should be accomplished shortly (the company is evaluating contractors). The seismic programme should take six months (gross cost $10-12m). This will allow siting of a well (gross cost $15m) and the issue of a CPR. If successful, 2013 will see the well be placed on extended well test (EWT), generating cash flow and the possibility of booking reserves. The company is funded for the seismic programme.

Nigeria – OPL 281 – onshore with potential

SacOil and its partners, EER and Transcorp are still awaiting the final award of the PSC and perfection of title of the assets for block OPL 281. OPL 281 is in the western delta of Nigeria and covers 138 km^2 onshore. Two wells were drilled in 1967 and 1970 but were not subsequently developed.

The two previous wells Ekoro-1 (1967) and Obote-1 (1970) have limited data. Gross estimates of the field range from 63.8mbbls (1C) to 145.2mbbls (3C). These include uncertainties in the type of hydrocarbon – TRACS say the low case would indicate a reservoir with gas cap. The proximity to existing infrastructure means a development could be swift.

The work commitment requires a spend of at least $30m per phase (two wells and 3D seismic acquisition/processing), of which SacOil will pay the majority. After this, SacOil will earn a 20% paying working interest and a 30% participation interest (20% once cumulative production exceeds 50mbbls gross).

Based on data provided by SacOil's partner EER and 3D performed by Shell in 1991/1992, TRACS' CPR estimated that the block contains estimated recoverable contingent resources of 98mmboe (P50). This implies 2C unrisked contingent resources net to SacOil of 14.5mbbls with best-estimate risked contingent resources of 8.7mbbls. TRACS believes the P50 volume would support a development with peak production of up to 30kbd.

Work programme and catalysts

No PSC has yet been awarded – the company expects this in the next month. As the concession has existing 3D seismic, the company plans to start reprocessing in Q412. Once complete, the company will issue a CPR and plan to drill a well, probably in Q213, at a cost of around $10-15m. If successful, the company will likely put the well on an extended test and convert the OPL (exploration) to an OML (production).

DRC Block III – potential jewel in the crown?

SacOil owns a 12.5% economic interest in Block III, an onshore block in the Albertine Graben, DRC, which covers 3,177 km^2. The block is a potentially exciting exploration area as it is on-trend with the Lake Albert discoveries in Uganda (including Kingfisher, 200mboe and Giraffe-Buffalo, 300mboe) and has attracted Total as a farm-in partner. Gravity and magnetic data has recently been acquired and are being processed. Preliminary results show an encouraging trend that compares well with the gravity map published by Tullow on the Ugandan part of Lake Albert. In addition, oil seeps are evident in the Northern end of the block and the area is considered to be highly prospective by the company. Independent consultants Bayfield expect the block contains a continuation of the plays seen elsewhere in the Albertine Graben in the north, while a smaller kitchen is possible in the south.

Bayfield has estimated gross prospective liquids resources across the block of 1.5bnbbls (best estimate), but we expect work performed by the JV to update this rough estimate.

On 4 March 2011, Total farmed-in to the block and has since raised its stake to 67% (in March 2012). Total's presence gives significant credibility to the potential value of the block for SacOil; it has good knowledge of the area following its farm-in to the Lake Albert (Kingfisher) acreage of Tullow. Total will carry SacOil's costs until an FID is taken, if at all, and pay further instalments if this is reached ($58m on FID and $50m on first oil – SacOil will receive half), thereby protecting the company from capital outlays in the near term. The deal therefore converted SacOil's interest in the block into a call option on exploration in a region with significant proven oil resources.

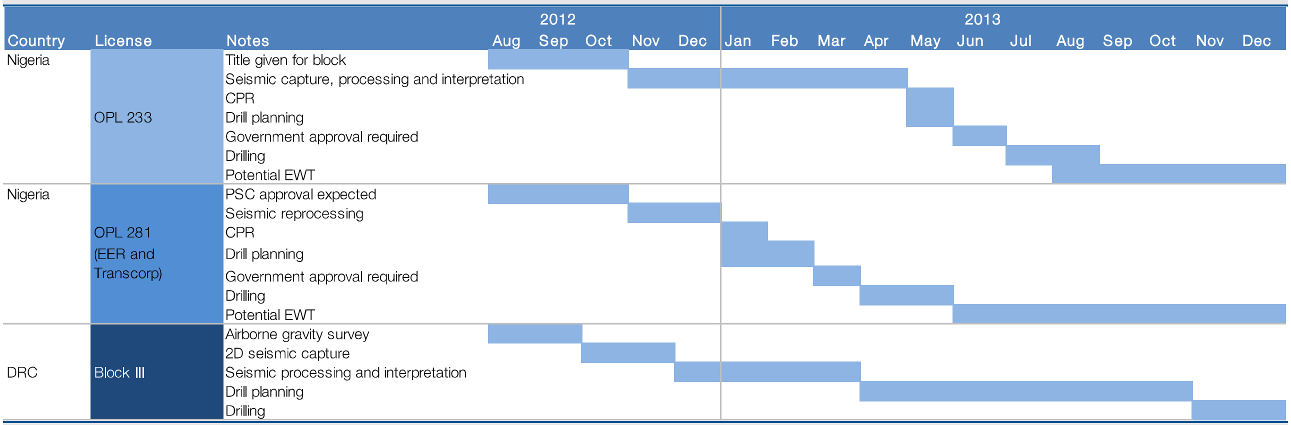
To balance this, it is unlikely that Total, as a major, will move as quickly as a smaller, independent company. In the original farm-in announcement, SacOil noted that Total would "use its reasonable endeavours to ensure that one exploration well is drilled by the Block III Contracting Party in Block III before 31 December 2012". This has slipped – we note that Total describes the likely spud date for a well to be 2013+ in its investor presentation. Investors will likely be waiting more than a year before oil resources are conclusively shown to be in the block.

Work programme

By December 2011, Total had completed the acquisition and interpretation of satellite imagery of the block and an aeromagnetic survey, which has broadly confirmed its initial interpretation. The next step will be 2D seismic acquisition. This replicates the approach taken in the Lake Albert area by Tullow. Seismic acquisition and drilling is dependent on weather, and will only happen in the dry season (September to April). We would expect a well to be drilled towards the end of 2013 or early 2014.

Summary of the work programme and funding position

Exhibit 4: Summary of work programme for SacOil's assets



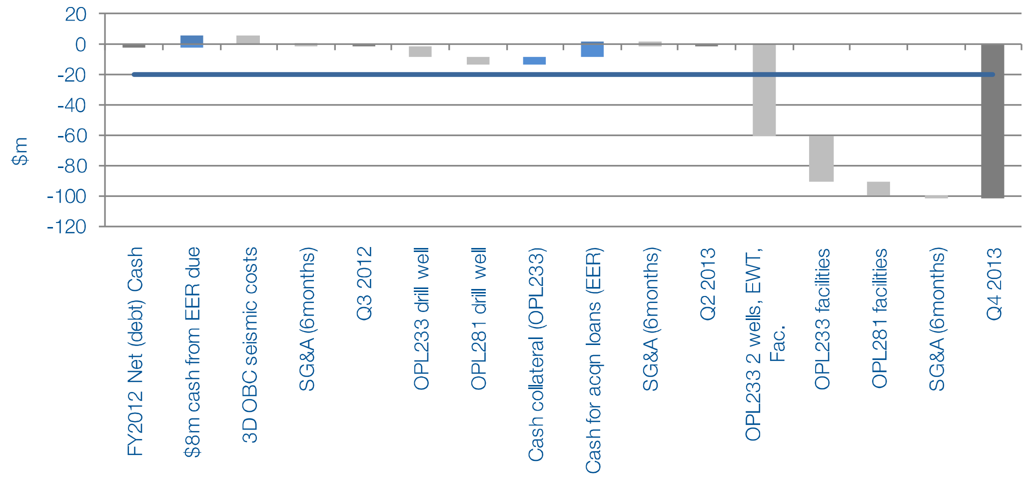
Source: SacOil

Cashflow expectations

SacOil is entering a period of activity and the next six months will see exploration drilling in Nigeria (OPL 233 and OPL 281) and further work in the DRC. As a result, we expect cash outflows. However, the company has resources to meet these requirements in the near term. Expenditure will be balanced by cash ($8m) it expects to receive from EER for the performance bond and $10m in 2013 in repayment of acquisition loans (collateralised against the interest in OPL 233 and OPL 281). The company also has c $20m of its SEDA still available, on our calculations.

We note that in the case of successful exploration on the assets, the company will have to spend large amounts to develop the fields, although we would expect a mix of funding to be available at this point. We detail the cash inflows/outflows in the chart and table below:

Exhibit 5: Net debt progression over time



Source: Edison Investment Research, SacOil. Note: Chart indicates calendar dates, not FY reporting.

Exhibit 6: Net debt progression

Item	$m
FY2012 net (debt) cash	**(2.6)**
$8m cash from EER due	8.0
3D OBC seismic costs	(5.0)
SG&A (six months)	(1.5)
Subtotal Q312	**(1.1)**
OPL 233 drill well	(7.5)
OPL 281 drill well	(5.0)
Cash collateral (OPL 233)	5.0
Cash for acqn loans (EER)	10.0
SG&A (six months)	(1.5)
Subtotal Q213	**(0.1)**
In the case of successful exploration at both OPL 233 and OPL 281	
OPL 233 twp wells, EWT, Fac.	(60.0)
OPL 233 facilities	(30.0)
OPL 281 facilities	(10.0)
SG&A (six months)	(1.5)
Subtotal Q413	**(101.6)**

Source: Edison Investment Research, SacOil

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Exhibit 7: Financial summary

		2009	2010	2011	2012
February	ZAR 000's	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		**20,802**	**31,724**	**35,143**	**37,173**
Cost of Sales		(16,395)	(20,210)	(23,615)	(26,569)
Gross Profit		4,407	11,513	11,528	10,603
EBITDA		**(27,991)**	**714**	**(29,336)**	**82,167**
Operating Profit (before amort. and except.)		**(27,579)**	**1,370**	**(28,680)**	**82,167**
Intangible Amortisation		0	0	0	0
Exceptionals		0	0	0	0
Other		0	(3,016)	(2,229)	(20)
Operating Profit		**(27,579)**	**(1,647)**	**(30,909)**	**82,146**
Net Interest		464	718	1,254	(16,571)
Profit Before Tax (norm)		**(27,115)**	**2,087**	**(27,426)**	**65,595**
Profit Before Tax (FRS 3)		**(27,115)**	**(929)**	**(29,655)**	**65,575**
Tax		0	895	(95)	(155,309)
Profit After Tax (norm)		**(27,115)**	**(34)**	**(29,750)**	**(89,734)**
Profit After Tax (FRS 3)		**(27,115)**	**(34)**	**(29,750)**	**(89,734)**
Average Number of Shares Outstanding (m)		313.3	313.3	449.6	717.4
EPS - normalised (R)		(8.7)	(0.0)	(6.6)	(11.7)
EPS - normalised and fully diluted (R)		(8.7)	(0.0)	(6.6)	(11.7)
EPS - (IFRS) (R)		(8.7)	(0.0)	(6.6)	(11.7)
Dividend per share (R)		0.0	0.0	0.0	0.0
Gross Margin (%)		21.2	36.3	32.8	28.5
EBITDA Margin (%)		-134.6	2.3	-83.5	221.0
Operating Margin (before GW and except.) (%)		-132.6	4.3	-81.6	221.0
BALANCE SHEET					
Fixed Assets		**7,709**	**8,535**	**446,373**	**519,575**
Intangible Assets		0	0	394,642	181,996
Tangible Assets		4,838	7,640	6,644	6,148
Investments		2,871	895	45,087	331,431
Current Assets		**40,369**	**40,942**	**38,039**	**98,533**
Stocks		2,048	2,305	2,408	2,540
Debtors		3,462	3,772	6,318	9,819
Cash		6,856	6,998	17,899	10,774
Other		28,003	27,867	11,413	75,400
Current Liabilities		**(6,308)**	**(5,213)**	**(13,887)**	**(45,530)**
Creditors		(6,308)	(5,213)	(13,887)	(45,530)
Short term borrowings		0	0	0	0
Long Term Liabilities		**706**	**934**	**946**	**(121,602)**
Long term borrowings		0	0	0	(28,939)
Other long term liabilities		706	934	946	(92,662)
Net Assets		**42,476**	**45,197**	**471,470**	**450,977**
CASH FLOW					
Operating Cash Flow		**(1,754)**	**443**	**(21,796)**	**(179,769)**
Net Interest		0	0	0	0
Tax		0	0	0	0
Capex		0	(263)	(54,475)	0
Acquisitions/disposals		0	0	0	0
Financing		0	108	132,649	120,956
Dividends		0	0	0	0
Net Cash Flow		(1,754)	287	56,378	(58,813)
Opening net debt/(cash)		**0**	**(6,856)**	**(6,998)**	**(17,899)**
HP finance leases initiated		0	0	0	0
Other		8,629	(145)	(45,477)	22,749
Closing net debt/(cash)		**(6,875)**	**(6,998)**	**(17,899)**	**18,165**

Source: Company financial statements

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