# Not every oil company is struggling this year

## Juniors have continued developing new projects despite greater awareness of peak oil and stranded assets, and getting gains to go with positive announcements

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This year, oil companies have been pummelled both by the Covid-19 pandemic and investors shifting cash into greener investments. Even those sticking around face slashed dividends and multi-year share price lows, particularly in London's two supermajors, **Royal Dutch Shell (RDSB)** and **BP (BP.)**.

Amid the talk of stranded assets and that BP plans to let production drop by hundreds of thousands of barrels a day in the coming years, juniors are still hard at work developing new assets. The market is reflecting this. Share prices for oil and gas companies on Aim are flat year-to-date, according to FactSet, compared with members of the FTSE 350. The average decline in that group, year-to-date, is 37 per cent.

Shell and BP are the biggest drag on the cohort, with 60 per cent and 55 per cent declines, respectively. Panmure Gordon analyst Colin Smith said the two former FTSE 100 dividend leaders were facing long-term headwinds. "The oil sector continues to de-rate against the market in a process that appears to have started in the middle of last year and has accelerated in 2020, taking the sector to the lowest [point] relative to markets since records began," he said.

Mr Smith said one driver of the sector weakness was the equity cost of capital going up, which he said would result in a "prolonged dislocation" in company valuations compared with how they were rated by the market previously. Now investors might have to look further down the ladder for growth in the oil and gas sector.

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### Getting on with it

**Bahamas Petroleum (BPC)** was looking at years of work going up in smoke in March. The explorer, then only focused on a single offshore oil project, had declared force majeure to extend its drilling licence and postponed the arrival of a rig once Covid-19 hit.

"In the first week of March, we were three weeks away from spudding the well," said chief executive Simon Potter. "We entered Covid lockdown in quite a forlorn mood really, having spent so many years building up the case to go drilling, having pulled all the various bits and pieces together, having ordered, bought and paid for the critical items and long-lead items."

The company had the added difficulty of waiting until the Bahamas' hurricane season between July and November was over. It wasn't idle in this time and completed an all-share merger with Columbus Energy and won an auction for an offshore bloc in Uruguay.

The company's share price has not recovered from the excitement before postponed drilling in March, when it hit over 4p. Bahamas Petroleum is now trading around 2.1p. A discounted fundraising at the end of September dropped the shares further from the rig announcement just a week earlier.

While the restart is on track for the company, circumstances are different for the Perseverance well now. Its net present value (NPV) is less than half of what it was when oil was above $60 a barrel, at $2.5bn. The price is unlikely to recover quickly as Opec producers have kept supply high despite demand not recovering in the second half due to continued Covid-19 restrictions.

Another Aim junior getting on with exploration is **Reabold Resources (RBD)**, which spudded the UK onshore West Newton B-1 well in the first week of October. The company is evaluating two prospects, one the more certain Kirkham Abbey formation and the other the deeper Cadeby formation. There's a base case resource estimate for Kirkham of 65m barrels of oil equivalent (boe) and a less certain prospective resource of 79m boe at Cadeby.

Reabold will be hoping for a major share price rerating once the test drilling is done in 6-10 weeks. It is trading around a quarter down from its 2020 peak of almost 80p, although swings like this are common for companies at this stage.

### Plandemic

Oil dropping to $40 a barrel and staying there for some time – as current Covid-19 spikes and Opec's commitment to keep supply high indicate – means new projects have to be re-evaluated.

The Bahamas Petroleum boss said the field Perseverance-1 was tapping was big enough to warrant continuing the project, even if oil stays low. "This is a company maker," he said. "The target structure that we're looking to drill is some 80km long. The segment of the structure that we're drilling is 770m barrels."

Reabold is less exposed to oil because of the gas content of its 56-per-cent-owned asset. The split between pure oil explorers and those with gas is best demonstrated by **Touchstone Exploration (TXP)**, one of London's best performers this year. The company had confirmed a major find in Trinidad and Tobago before Covid-19 really hit, and is up 270 per cent since the start of the year. It dipped during the March crash but recovered within two months.

Bahamas' moves to diversify during lockdown show an awareness that exploration is a tricky business. Investors diving into the murky world of early-stage oil and gas companies are taking much more of a punt than buying established players, although the majors have shown plenty of ability to destroy value as well.

The dual sets of risks faced by explorers and operators are shown well by two partners in the Orinduik project, offshore Guyana. **Tullow Oil (TLW)** is the operator and **Eco Atlantic Oil and Gas (ECO)** has a 15 per cent stake. Tullow had reported promising results from an offshore Guyana wildcat well in August last year, which saw its share price climb almost a third. The Joe and Jethro wells had a much greater impact on junior partner Eco Atlantic, which does not have any producing assets.

The promising drilling news triggered a doubling of Eco Atlantic's share price over the following month to 175p, before a crash back to 60p when Tullow said there was little commercial value in what it had found. Tullow proved with its guidance cut and removal of the chief executive and exploration boss in December that having risk spread over several assets is not enough to protect shareholder value. It is now trading at less than 10 per cent of its valuation of 12 months ago.

**We should be clear: looking down the ladder at junior companies comes with major risk. One or two disappointing holes can send them into a tailspin, and development brings its own problems, through funding, licensing and operational issues. The industry is going through a major shift, however, and investors keen to stick with it will have to look beyond the majors for growth.**

## The eight-year-old corruption case that still matters

Pointing out malfeasance in the extractives industry can turn you into a broken record: corruption this, fraud that. But two major stories came out in recent weeks that show how uneven the playing field can be for the humble investor, especially if regulators can't get to the bottom of a situation.

One, a dive into the Department of Justice (DOJ) and FBI investigation on metals trading at US bank JP Morgan by Bloomberg, showed how precious metals traders could fiddle markets to their own advantage. This was done by placing spoof orders for a commodity to encourage buyers or sellers to bite or even move the price.

When trader John Desmond pled guilty in 2018, William Sweeney from the FBI said he was attempting "to profit off of an unfair market that he helped create". Bloomberg says the bank could pay a $1bn fine for its traders' actions.

The second showed how tough it is to get to the bottom of mining deals done across several countries with multiple parties involved. Eurasian Natural Resources Corporation (ENRC) is a miner that was listed in London for six years until 2013. ENRC, which was taken private by its major shareholders via the Eurasian Resources Group (ERG) vehicle, is the subject of a now-eight-year-long Serious Fraud Office (SFO) investigation into "allegations of fraud, bribery and corruption" relating to asset purchases.

An investigation by our sister publication the *Financial Times* raised even more questions over ENRC at the start of October, going beyond allegations of dodgy dealing, which the company denies.

*Financial Times* journalist Mike Burgis has dug through the details around two ENRC employees dying in the US in 2015. This is now under investigation by the FBI, according the local police who initially handled the inquiry.

The company denies any involvement with their deaths, which were initially put down to malaria. The two men were part of ENRC's African operation, which is at the heart of the SFO investigation. The other death was the murder of a geologist who had questioned the value of a South African project ENRC bought for $295m in December 2011. We don't need to go into the sticky details of his death, but the *Financial Times* report raised the possibility he was an SFO witness when he was killed in 2016.

Once again ERG said ENRC had had no involvement in the man's death.

Of course for investors, ENRC is done and dusted. But the combination of the long-term SFO investigation – which began with the company investigating itself at the enforcement body's request – and its second life as ERG means it is still a key test of corporate governance rules in London.

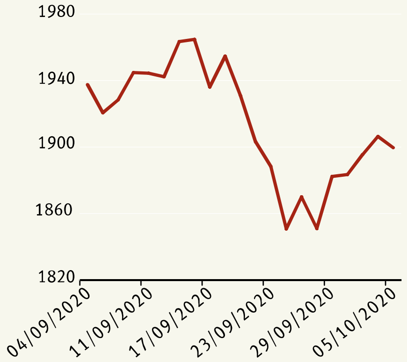
Fellow miner **Ferrexpo (FXPO)** offers an example of a current London-listed company with a major shareholder in legal trouble allowed to trade as normal.

ERG is now part of the Global Battery Alliance alongside Volkswagen, BMW and Microsoft, among many other corporate giants. There is no reason it shouldn't be part of this organisation: as a major miner in the Democratic Republic of Congo, it sells child-labour-free cobalt, and the SFO has yet to properly put its case before a court. But these buyers and their end consumers should have a clearer picture on who they are dealing with, and the SFO should provide that as soon as possible.

*Alex Hamer*

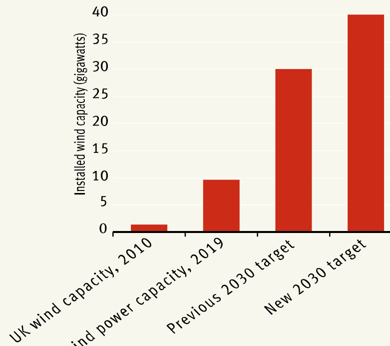
## COMMODITIES DATABANK

### Saxo Bank says Biden win priced in to gold price, pushing it higher



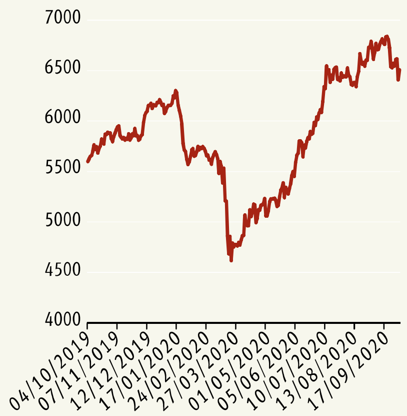

Source: FactSet/London Bullion Market Associatior

### Boris Johnson says UK will quadruple wind capacity within a decade




Source: GlobalData

### Copper dips after 12-month peak




Source: FactSet/London Metal Exchange