

SEPLAT Earnings Review 2019

Stock rating: HOLD
Target Price: N594.04/s
Closing Price: N544.50/s

FY 2019: Earnings beat estimate on strong Q4 recovery

- Revenue declined by 6.5% y/y
- Gross margin expands 4.3ppts,
- Profit before tax grew by 11.3% y/y, supported by lower finance costs
- The company announced final dividend of 5 cents

Company Information	
TTM P/B (x)	0.45x
TTM P/E (x)	3.04x
EV/EBITDA (x)	3.15x
Dividend Yield	7.4%
Free Float	47.5%
Market Cap (N'bn)	320.4

Lower liquids production and price pressures revenue

Last week, SEPLAT released its FY 2019 results reporting a revenue decline of 6.5% y/y to US\$697.8m in FY 2019 from US\$746.1m in FY 2018. On a q/q basis, revenue climbed 45.1% q/q to US\$202.9m in Q4 2019, from US\$140.0m in Q3 2019. We note that FY 2019 revenue beat our estimate of US\$659.8m by 5.7% due to recovery in liquids production in Q4. Crude oil revenue printed at US\$495.1m, a 16.2% y/y decline from 2018's US\$590.5m, while gas revenue gapped higher by 30.2% to US\$202.7m in 2019 from US\$155.6m in 2018. The jump in gas revenue was due to a one-off payment from Nigeria Petroleum Development Company (NPDC) for gas processed from OML 4, 38 & 41 between 2015-2018. Excluding the one-off income, gas revenue would have printed lower by 12.8% y/y, reflecting a lower average realized gas price of US\$2.84/Mscf (vs US\$2.94/Mscf in 2018) and lower gas sales volume of 131 Bscf (vs 145 Bscf in 2018). In addition, crude oil revenue was lower due to a confluence of a lower average crude oil price realised (down 8.6% y/y to US\$64.40/bbl) as well as lower liquids production (down 6.8% y/y to 23,935 bopd on a working interest basis). Overall production level (Gas & Crude Oil) was lower by 6.8% y/y to 46,498 bopd on a working interest basis.

Margins expand despite higher per barrel production cost

Gross profit was marginally higher by 1.2% y/y to US\$395.7m in FY 2019 from US\$391.2m in FY 2018, while gross margin expanded 4.3ppts y/y to 56.7%. The marginal rise was driven by lower cost of sales which fell 14.9% y/y to US\$302.0m in FY 2019. The decline in cost of sales was driven by lower non-production costs consisting of depletion, depreciation & amortisation (down 23.8% y/y) as well as royalties (down 22.2% y/y). Direct costs were relatively flat as lower crude-handling fees (down 16.2% y/y to US\$57.4m) muted the significant bump in Rig related costs (up 15,543.6% to US\$6.1m). We note the significant bump in Rig related costs was driven by workovers carried out on oil wells during the year. On the downside, production opex was higher on a cost-per-barrel basis printing at US\$6.20/boe in FY 2019 as against US\$5.77/boe due to lower production volumes during the year.

Operating profit climb despite higher impairments

The company recorded a marginal uptick in operating profit by 0.7% y/y to US\$312.0m in FY 2019, from US\$309.9m in FY 2018. This was despite a 231.8% spike in financial assets impairment which was offset by lower administrative costs (down 11.4% y/y) and higher other operating income (up 99.5% y/y). Administrative expenses was lower due to other general costs and consulting fees.

Finance costs edge lower despite rise in IBLs

The company recorded a 56.9% y/y decline in net finance costs driven by higher finance income (up 36.0% y/y to US\$13.5m) and lower finance costs (down 40.6% y/y to US\$33.5bn). Interestingly, the company's Interest Bearing Loans & Borrowings (IBLs) climbed higher by 77.1% y/y to US\$789.4m. We note the reason the full impact of the climb in IBLs was not felt in 2019, was due to the fact the company took on a new revolving credit facility from Citibank on December 20th, which it used to partly finance the acquisition of Eland. Against the backdrop of lower net finance costs, profit before tax climbed 11.3% y/y to US\$293.0m in FY 2019. Furthermore, the company was granted its tax holiday which reflected in a lower effective tax rate for 2019 printing at 9.9% (vs. 44.4% in 2018) and consequently a 75.1% y/y decline in tax expenses. Against this backdrop, profit from continued operations printed at US\$263.8m in FY 2019 representing an 80.1% climb. The company also booked a profit from discontinued operations of US\$13.1m, following the deconsolidation of ANOH Gas Processing Company Limited in April 2019. Thus, total profit for the year printed at US\$277.0m for FY 2019 representing an increase of 89.0%, over 2018's US\$146.6m. The company's FY 2019 net income exceeded our estimate of US\$223.6m due to the strong recovery in liquids production Q4.

Company announces final dividend of 5cents

The company announced final dividend of 5cents per share in addition to the interim dividend of 5cents paid earlier in the year. The total dividend of 10cents paid implies a payout ratio of 20.5% for FY 2019.

Outlook: Lower price and demand weigh on outlook

Significant headwinds to Revenue growth

Looking ahead to 2020, our searchlight beams on weaker oil & gas price as well as lower global demand for oil. The Coronavirus outbreak remains a significant concern weighing on global demand for oil. This has consequently fed into a heavy crash in global oil and gas prices. Nevertheless, we note SEPLAT announced it has hedged 4.5MMbbl of crude supplies with put options exercisable at US\$45.0/bbl. Thus, our forecast for average realizable sale per barrel prints higher than the forecast for benchmark Brent crude, at US\$40.73/bbl. In addition, we expect lower global demand to feed into the company's production in 2020. Thus, we forecast a 20.0% decline in average daily working interest for liquids to 19.15kboepd, while we remain slightly optimistic on gas production, which we expect average daily working interest to print higher by 3.0% to 23.24kboepd. Total average daily working interest is expected to settle at 42.39kboepd, which is lower than the lower band of the company's guidance (47.00kboepd – 57.00kboepd). This consequently implies we forecast a steep 41.1% y/y decline in revenue to US\$411.0m for FY 2020e.

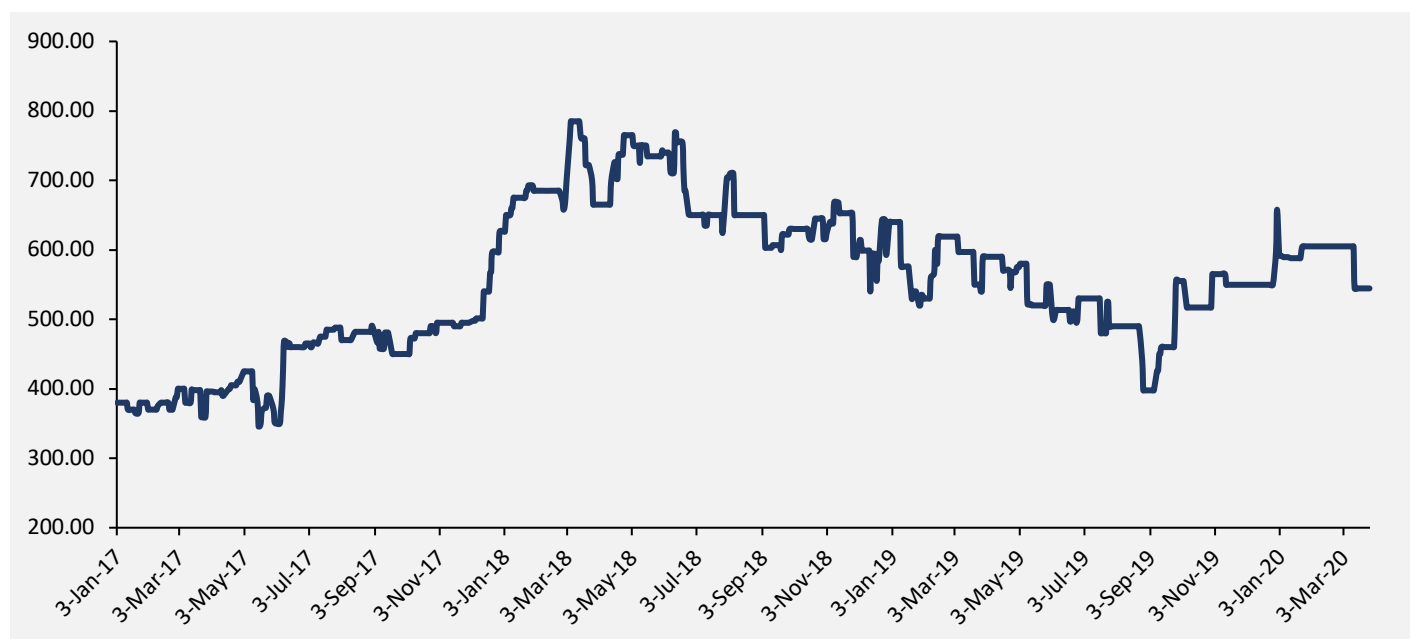
Tight cost management but lower profits

We expect management to rein in on costs and drive production efficiency in the face of a steep decline in revenue. Thus, our operating margin forecast for 2020 reflects a mild decline to 43.4%. However, the decline in revenue is expected to feed into lower operating profits as we forecast a 42.9% y/y dip in operating income. We forecast a bump in finance costs due to the additional US\$350.0m revolving credit line taken from Citibank towards the close of last year. Therefore, we project a 65.4% y/y rise in finance cost. Nevertheless, we expect an improved finance income and extension of the 2-year tax holiday to feed into profits. Again, we see these having minimal impacts, as we project a 62.9% slump in net income.

Limited upside on near term headwinds...HOLD rating recommended

While we note SEPLAT has been on the receiving end of heavy sell-offs in recent times, we consider the sell-offs justified given the oil & gas upstream industry to face sizable headwinds to growth in the near term. Consequently, we place the stock on a HOLD recommendation with a target price of US\$1.65/s. At an exchange rate of N360/US\$, our target price in Naira terms to print at N594.04/s which implies a 9.10% upside to Monday's closing price of N544.50/s.

SEPLAT 3-Year Historical Price Movement



Source: Bloomberg, FSDH Research

SEPLAT Plc Earnings Highlight FY 2019

US\$'000	FY 2019	FY 2018	y/y	Q4 2019	Q3 2019	q/q
Revenue	697,777	746,140	-6.5%	202,897	139,794	45.1%
Cost of Sales	(302,039)	(354,926)	-14.9%	(71,821)	(82,165)	-12.6%
Gross Profit	395,738	391,214	1.2%	131,076	57,629	127.4%
Other Income	29,876	14,977	99.5%	(6,415)	27,676	-123.2%
General & Administrative Expenses	(70,617)	(79,711)	-11.4%	(16,061)	(12,472)	28.8%
Impairment losses on financial assets	(48,581)	(14,643)	231.8%	(8,445)	-	n/a
Fair value gain/(loss)	5,559	(1,936)		626	(722)	
Operating Profit	311,975	309,901	0.7%	100,781	72,111	39.8%
Finance Income	13,471	9,905	36.0%	4,302	3,535	21.7%
Finance Costs	(33,539)	(56,492)	-40.6%	2,756	(11,500)	-124.0%
Net Finance Income/(Cost)	(20,068)	(46,587)	-56.9%	7,058	(7,965)	-188.6%
Share of profit from joint venture accounted for using the equity method	1,060	-		318	488	
Profit before Tax	292,967	263,314	11.3%	108,157	64,634	67.3%
Income Tax (Expense)/Credit	(29,125)	(116,788)	-75.1%	(25,731)	(1,968)	1207.5%
Profit from continued operations	263,842	146,526	80.1%	82,426	62,666	31.5%
Profit from discontinued operations	13,166	50	26232.0%	9,984	-	n/a
Profit for the period	277,008	146,576	89.0%	92,410	62,666	47.5%

Other Key Inputs	FY 2019	FY 2018	y/y	Q4 2019	Q3 2019	q/q
Basic Earnings Per Share	0.49	0.26	89.2%	0.16	0.11	47.7%
Diluted Earnings Per Share	0.48	0.25	90.6%	0.16	0.11	48.7%
EBITDA	405,891	432,284	-6.1%	102,536	73,866	38.8%

Margins	FY 2019	FY 2018	y/y	Q4 2019	Q3 2019	q/q
Gross Margin	56.7%	52.4%	4.3ppts	64.6%	41.2%	23.4ppts
EBITDA Margin	58.2%	57.9%	0.2ppts	50.5%	52.8%	-2.3ppts
Operating Margin	44.7%	41.5%	3.2ppts	49.7%	51.6%	-1.9ppts
Net Margin	37.8%	19.6%	18.2ppts	40.6%	44.8%	-4.2ppts
Basic Outstanding Shares	568,497	569,228		568,497	569,228	
Diluted Outstanding Shares	576,703	581,615		576,703	581,615	

Source: Company Financials, FSDH Research

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FSDH Forecast

Nm (unless otherwise stated)								
Income Statement	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Revenues	452,179	746,140	697,777	410,980	354,979	393,455	424,509	464,052
Cost of Sales	(240,059)	(354,926)	(302,039)	(184,941)	(159,741)	(177,055)	(191,029)	(208,823)
Gross Profit	212,120	391,214	395,738	226,039	195,239	216,400	233,480	255,229
Other Income	682	14,977	29,876	8,220	7,100	7,869	8,490	9,281
General & Administrative Expenses	-92,130	-79,711	-70,617	-41,098	-35,498	-39,346	-42,451	-46,405
Other Items	(8,258)	(16,579)	(43,022)	(15,000)	(15,000)	(15,000)	(15,000)	(15,000)
EBIT	112,414	309,901	311,975	178,161	151,840	169,924	184,519	203,104
Net Finance (cost)/ income	(68,418)	(46,586)	(20,068)	(40,183)	(24,240)	(19,185)	(3,558)	(1,340)
PBT	43,996	263,315	291,907	137,978	127,600	150,738	180,962	201,764
JV Share of Profit accounted for using Equity method	-	-	1,060	-	-	-	-	-
Taxation	221,233	(116,788)	(29,125)	(35,297)	(38,835)	(45,877)	(55,075)	(61,406)
Profit from continued operations	265,229	146,527	263,842	102,681	88,765	104,862	125,886	140,358
Proffit from discontinued operations	-	50	13,166	-	-	-	-	-
Minority Interest	-	-	161,208	181,060	206,995	226,212	238,628	254,736
Net Income Ex-Minority Interest	263,407	146,577	277,008	102,681	88,765	104,862	125,886	140,358
EPS, US\$	0.46	0.25	0.48	0.18	0.15	0.18	0.22	0.24
DPS, US\$	-	0.15	0.10	0.05	0.04	0.05	0.06	0.06
Dividend Sum	571,651	576,703	581,615	581,615	581,615	581,615	581,615	581,615
Balance Sheet	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Oil & Gas Properties	1,286,387	1,271,923	1,558,213	1,504,220	1,430,075	1,357,907	1,286,798	1,217,423
Other PPE	5,078	4,237	14,201	12,267	10,084	9,077	7,675	6,315
Right of Use Assets	-	-	13,115	13,115	13,115	13,115	13,115	13,115
Other Asset	217,031	167,100	130,915	130,915	130,915	130,915	130,915	130,915
Other Non-current Assets	256,293	193,583	621,226	618,990	616,693	614,428	612,188	609,981
Non-Current Assets	1,764,789	1,636,843	2,337,670	2,279,507	2,200,882	2,125,441	2,050,692	1,977,749
Inventories	100,336	102,554	84,508	53,633	49,520	60,199	61,129	62,647
Trade and Other Receivables	310,345	136,393	486,762	214,630	165,968	221,302	219,647	239,360
Cash at Bank and in hand	437,212	584,723	333,028	305,908	448,082	525,534	667,345	834,034
Contract Assets	-	14,096	21,259	21,259	21,259	21,259	21,259	21,259
ST Prepayments	1,948	11,561	6,397	4,993	3,994	4,072	4,967	5,221
Derivatives not designated as hedges	-	8,772	1,486	1,486	1,486	1,486	1,486	1,486
Current Tax Assets	-	2,356	-	-	-	-	-	-
Current Assets	849,841	860,455	933,440	601,909	690,308	833,852	975,833	1,164,007
Total Assets	2,614,630	2,497,298	3,271,110	2,881,417	2,891,190	2,959,293	3,026,524	3,141,756
LIABILITIES								
Bank Overdraft	-	-	-	-	-	-	-	-
Contingent consideration	-	-	-	-	-	-	-	-
Interest Bearing Loans and Borrowings	265,400	9,872	112,333	173,339	140,011	127,852	115,075	91,919
Trade and Other Payables	410,593	284,565	468,804	236,725	207,663	224,860	225,415	263,117
Lease Liabilities	-	-	692	692	692	692	692	692
Taxation	4,133	-	18,502	18,502	18,502	18,502	18,502	18,502
Contingent Liabilities	-	-	7,217	7,217	7,217	7,217	7,217	7,217
Contract Liabilities	-	-	16,301	16,301	16,301	16,301	16,301	16,301
Current Liabilities	680,126	294,437	623,849	452,775	390,386	395,424	383,201	397,748
Interest bearing loans and borrowings	304,677	435,827	677,075	381,444	387,033	371,453	356,491	351,907
Lease Liabilities	-	-	8,518	8,518	8,518	8,518	8,518	8,518
Contingent Consideration	13,900	18,489	-	-	-	-	-	-
Provision for Decommissioning Obligation	106,312	141,737	147,921	147,921	147,921	147,921	147,921	147,921
Defined Benefit Plan	6,518	5,923	9,808	9,808	9,808	9,808	9,808	9,808
Deferred Tax Liabilities	-	-	-	-	-	-	-	-
Other Liabilities	-	-	-	-	-	-	-	-
Non-Current Liabilities	431,407	601,976	843,322	547,691	553,280	537,700	522,738	518,154
Total Liabilities	1,111,533	896,413	1,467,171	1,000,467	943,666	933,123	905,939	915,903
Issued share capital	1,826	1,834	1,845	1,845	1,845	1,845	1,845	1,845
Share premium	497,457	497,457	503,742	503,742	503,742	503,742	503,742	503,742
Share Based Payment Reserve	17,809	27,499	30,426	30,426	30,426	30,426	30,426	30,426
Capital Contribution	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
Retained Earnings	944,108	1,030,954	1,249,156	1,326,167	1,392,741	1,471,387	1,565,802	1,671,070
Foreign translation reserve	1,897	3,141	2,391	2,391	2,391	2,391	2,391	2,391
Non-controlling Interest	-	-	(23,621)	(23,621)	(23,621)	(23,621)	(23,621)	(23,621)
Shareholders' Funds	1,503,097	1,600,885	1,803,939	1,880,950	1,947,524	2,026,170	2,120,585	2,225,853
Total equity and liabilities	2,614,630	2,497,298	3,271,110	2,881,417	2,891,190	2,959,293	3,026,524	3,141,756
Cash Flow	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Operating Cash Flow	447,042	501,544	337,758	328,429	253,263	192,692	249,577	280,048
Investing Cash Flow	6,821	(31,214)	(732,996)	(39,776)	(18,995)	(26,334)	(24,978)	(28,339)
Financing Cash Flow	(173,155)	(328,717)	145,239	(315,774)	(92,094)	(88,906)	(82,789)	(85,020)
Free Cash Flow	145,715	(53,393)	349,374	138,456	174,055	253,511	216,654	212,519

Source: Company Financials, FSDH Research