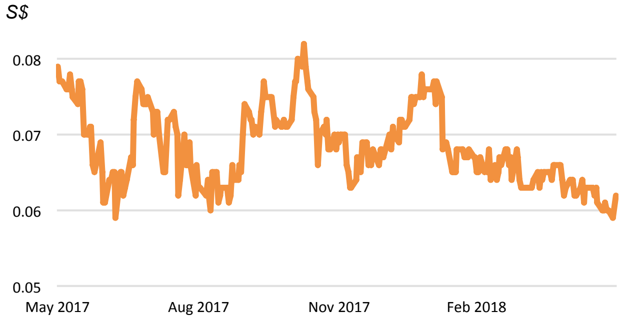
Interra Resources Limited

Date: 14 August 2018

BUY
(Maintained)

Target price: S$0.089
(+112%)

ITRR SP
Price: S$0.042 (as at 13 August 2018)



Share price	1M	3M	6M	1Y
Interra Resources	(16.0)%	(16.0)%	(19.0)%	(23.8)%
Straits Times Index	(0.0)%	(8.9)%	(5.0)%	1.9%

Market capitalisation	S$24.6 million
Current price	S$0.042
Shares outstanding	585,973,604
Free Float	17.6%
Major shareholders	North Petroleum International (1) 13.57% PT Saratoga Investama Sedaya (2) 13.54%
Recommendation of other brokers	N/A

Source: Company data, Bloomberg, SAC Advisors

(1) North Petroleum International Company Ltd is headquartered in Hong Kong. The Company's line of business includes the wholesale distribution of petroleum and petroleum products.

(2) Edwin Soeryadjaya and Sandiago Salahuddin Uno are deemed to have interests in all the shares held by PT Saratoga Investama Sedaya.

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Return to Profitability

Interra Resources Limited, and together with its subsidiaries, ("**Interra Resources**", "**Company**", or the "**Group**") reported second quarter results which saw revenue from continuing operations for the quarter at US $3.91 million, 33% higher than the previous quarter and 62% higher on a year-on-year basis. Overall, their revenue also benefited from the higher weighted average transacted oil price per barrel, which saw the Group's gross margins improved by 10.9% from 41.8% in the corresponding period to 52.7% this quarter. The stronger margins saw the Group report a profit of US$0.55 million, reversing the loss of US$0.65 million reported from the first quarter of 2018 and from the corresponding period last year.

Group reaped benefits of increased drilling activity with shareable production for the quarter increased to 62,260 barrels. The Group benefited from the increased drilling activity post contract extension, which saw higher shareable production from Myanmar in the second quarter. A total of 6 new wells were drilled during the quarter, and production has been gradually improving. Management also disclosed that with the additional 2 new wells drilled in July 2018, the incremental production is expected to reach the pre-contract extension level.

We maintain BUY with a target price of S$0.089 based on a conservative target 6.4x EV/1P Reserves. This is a 50% discount to the industry average. We believe Interra Resources is at a key inflexion point. Firmer oil prices and contract extensions have led to a turnaround in profitability, and we believe this would lift revenue further in FY2018. The stock trades at 0.7x of its book value, albeit sitting on net cash of US$5.7m as at June 2018. We maintain BUY with a target price of S$0.089, representing a 112% upside potential.

Key risks: (i) Variability in crude oil price and (ii) variability in final shareable oil production

Key Financials

Year ended December (US$'000)	FY2014	FY2015	FY2016	FY2017	FY2018E
Revenue	55,796	23,452	15,173	11,245	15,900
% Growth	11.2%	(58.0%)	(35.3%)	(25.9%)	41.4%
Gross profit	11,155	(10,621)	5,563	6,203	7,712
Gross profit margin	20.0%	(45.3%)	36.7%	55.2%	48.5%
Profit/(loss) before tax	(7,998)	(52,229)	(7,787)	1,212	635
Profit/(loss) before tax margin	NA	NA	NA	10.8%	4.0%
Profit/(loss) attributable to owners (3)	(10,794)	(47,417)	(8,041)	1,320	477
EPS/(LPS) (US cents)	(2.4)	(9.8)	(1.6)	0.3	NA
P/E (x)	NA	NA	NA	10.4	NA
P/B (x)	0.3	0.6	0.8	0.7	NA
Net Debt/Equity	Net cash	Net cash	Net cash	Net cash	Net cash

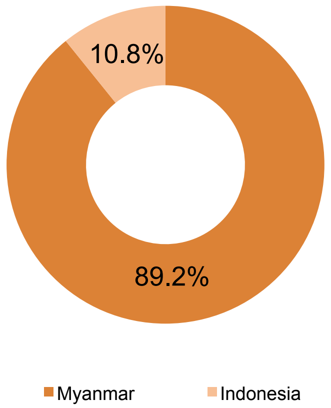
(3) Profit/(loss) attributable to equity holders of the Company from continuing operations

Increased shareable production and margins

Business Overview:

Interra Resources engages in the petroleum exploration production activities in Indonesia and Myanmar. They have a 60% interests in two onshore oil fields in Chauk and Yenangyaung, which contribute the bulk of revenue. Interra Resources was incorporated in 1973.

Net 1P Reserves (FY2017)



Source: Company data, SAC Advisors

Interra Resources reported second quarter results which saw revenue from continuing operations for the quarter at US$3.91 million, 33% higher than the previous quarter and 62% higher on a year-on-year basis. Overall, their revenue also benefited from the higher weighted average transacted oil price of US$70.39 per barrel vs. US$47.07 per barrel last year, which saw the Group's gross margins improved by 10.9% from 41.8% in the corresponding period to 52.7% this quarter. The stronger margins saw the Group report a profit of US$0.55 million, reversing the loss of US$0.65 million reported from the first quarter of 2018 and from the corresponding period last year.

Group reaped benefits of increased drilling activity with shareable production for the quarter increased to 62,260 barrels. The Group benefited from the increased drilling activity post contract extension, which saw higher shareable production from Myanmar of 55,691 barrels in the second quarter, up from 49,896 barrels in the previous year. A total of 6 new wells were drilled during the quarter, and production has been gradually improving. Management also disclosed that with the additional 2 new wells drilled in July 2018, the incremental production is expected to reach the pre-contract extension level. The increase this quarter however, was mitigated by the decrease of shareable production from LS TAC of 6,569 barrels vs. 9,593 in the previous year.

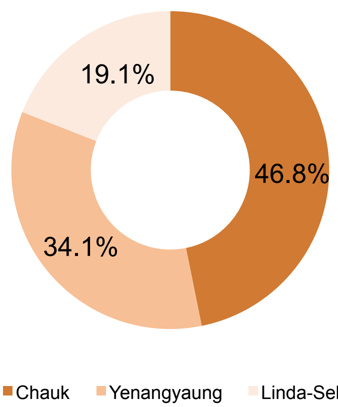
Water Flood project well underway, with improvements seen in the overall production level. Management disclosed that even though the Water Flood project is still in the early stage, marginal improvement, can be seen in the overall production level.

We maintained our BUY rating on Interra Resources with a target price of S$0.089 based on a conservative value of 6.4x EV/1P Reserves. We applied a 50% discount to the industry average of oil production companies with market capitalisation under US$200 million. We believe this is conservative, and the steep 50% discount takes into consideration of the risk of non-renewal of the Myanmar field post 2028. Interra has net attributable 1P reserves of 4.92m barrels, with 3P reserves at 8.43m barrels.

We believe Interra is at a key inflexion point with firmer oil prices and the recent contract extension set to see a rebound in their overall financials. For FY18E, we expect a greater than 40% jump in revenue and Interra to remain profitable due to low production cost. The share trades at only 0.7x of book value, and it has an enviable net cash of US $5.7m.

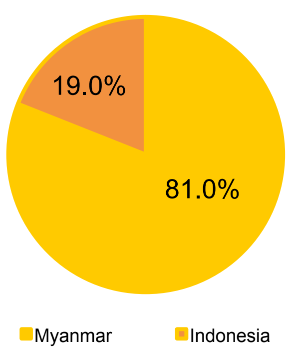
We see the current valuation as undemanding and maintain BUY with a target price of S$0.089, representing a 112% upside potential.

Revenue Breakdown (FY2017) – By oilfield



Source: Company data, SAC Advisors

Revenue breakdown (FY2017) – By country



Source: Company data, SAC Advisors

**The Group's revenue from Indonesia declined in FY17 vs. FY16 because the Technical Assistance Contract for the Tanjung Miring Timur field expired in December 2016.*

Company Background

Interra Resources is engaged in the business of petroleum E&P. Its E&P activities include petroleum production, field development and exploration. Interra Resources is positioning themselves to become a leading regional independent producer of petroleum. Its current portfolio of production, development and exploration assets comprises five petroleum contract areas in Indonesia and Myanmar.

Its operations in Myanmar, namely Chauk and Yenangyaung contributed 81.0% of total revenue as compared to 19.0% from Indonesia, which came solely from the Linda-Sele fields.

In line with the curtailment of the drilling programme for the past two years owing to the crude oil slump and contract expiry, the Group's total shareable oil production for FY2017 fell 48.2% to 261,635 barrels from 504,979 barrels for FY2016.

It was previously listed on the SGX Catalist Board before getting transferred to the SGX Mainboard on the 10 January 2013.

Petroleum Assets

Country/asset name	Effective interest (%)	Development status	Type of contract	Contract Expiry date	Contract area (km2)	Type of deposit
Myanmar						
Chauk Field	60.00	Producing	Improved Petroleum Recovery Contract ("**IPRC**")	3 Apr 2028	955	Hydrocarbon
Yenangyaung Field	60.00	Producing	IPRC	3 Apr 2028	845	Hydrocarbon
Indonesia						
Linda-Sele Fields	53.99	Producing	Technical Assistance Contract ("**TAC**")	15 Nov 2018	19	Hydrocarbon
Benakat Barat Field	30.65 (indirect)	Producing	Operations Cooperatio n Agreement ("**KSO**")	15 Mar 2024	73	Hydrocarbon
Kuala Pambuang Block	67.50	Exploration	Production Sharing Contract ("**PSC**")	18 Dec 2021	1,631	Hydrocarbon

Source: Company data, SAC Advisors

Income Statement (US$'000)

	Fiscal Year Ended				
	FY15	FY16	FY17	FY18E	FY19E
Revenue (1)	**23,452**	**15,173**	**11,245**	**15,900**	N/A
Less: Cost of sales	(34,073)	(9,610)	(5,042)	(8,189)	N/A
Gross Profit	(10,621)	5,563	6,203	7,712	N/A
Other income	324	63	594	395	N/A
Administrative expenses	(41,247)	(6,574)	(5,269)	(7,155)	N/A
Finance expenses	(59)	(82)	(130)	(130)	N/A
Share of losses of associated companies	(626)	(6,755)	(186)	(186)	N/A
Results from operating activities	(52,229)	(7,787)	1,212	635	N/A
Tax expense	(555)	(1,031)	(813)	(159)	N/A
Profit/(Loss) from discontinued operations for FY	(655)	(39)	(46)	0	N/A
Total profit/(loss)	**(53,439)**	**(8,857)**	**353**	477	N/A
Profit/(Loss) attributable to owners of company	**(47,719)**	**(8,062)**	**1,298**	**N/A**	**N/A**
Earnings/(Loss) per share:					
-Basic (US cents)	**(9.85)**	**(1.59)**	**0.26**	N/A	N/A
-Diluted (US cents)	**(9.85)**	**(1.59)**	**0.26**	N/A	N/A

(1) From continuing operations

Balance Sheet (US$'000)

	Fiscal Year Ended				
	FY15	FY16	FY17	FY18E	FY19E
As at 31 December					
Property, plant and equipment	133	92	95	N/A	N/A
Producing oil and gas properties	359	206	3,152	N/A	N/A
Exploration and evaluation costs	10,488	10,584	10,616	N/A	N/A
Other non-current assets	12,127	3,792	11,451	N/A	N/A
Total non-current assets	**23,107**	**14,674**	**25,314**	**N/A**	**N/A**
Inventories	6,804	4,880	5,202	N/A	N/A
Trade and other receivables	12,450	13,486	8,295	N/A	N/A
Cash and bank balances	17,828	14,087	11,291	N/A	N/A
Other current assets	777	377	353	N/A	N/A
Assets of disposal group classified as held-for-sale	4,452	4,599	4,496	N/A	N/A
Total current assets	**42,311**	**37,322**	**29,637**	**N/A**	**N/A**
Total assets	**65,418**	**52,103**	**54,951**	**N/A**	**N/A**
Share capital	69,258	69,258	69,258	N/A	N/A
Accumulated losses	(21,271)	(29,369)	(28,169)	N/A	N/A
Other reserves	(18,597)	(18,397)	(18,713)	N/A	N/A
Equity attributable to owners of the Company	**29,390**	**21,492**	**22,376**	**N/A**	**N/A**
Non-controlling interests	3,962	3,847	4,746	N/A	N/A
Total Equity	**33,352**	**25,339**	**27,122**	**N/A**	**N/A**
Provision for environmental and restoration costs	4,474	1,564	139	N/A	N/A
Other non-current liabilities	39	53	25	N/A	N/A
Non-current liabilities	**4,513**	**1,617**	**164**	**N/A**	**N/A**
Trade and other payables	16,096	9,499	13,234	N/A	N/A
Borrowings	3,728	3,739	3,736	N/A	N/A
Provision for environmental and restoration costs	-	3,300	1,581	N/A	N/A
Current income tax liabilities	6,657	7,327	7,604	N/A	N/A
Liabilities directly associated with disposal group classified as Held-for-sale	1,072	1,282	1,510	N/A	N/A
Current liabilities	**27,553**	**25,147**	**27,665**	**N/A**	**N/A**
Total liabilities	**32,066**	**26,764**	**27,829**	**N/A**	**N/A**
Total equity and liabilities	**65,418**	**52,103**	**54,951**	**N/A**	**N/A**

Cash Flow Statement (US$'000)

	Fiscal Year Ended				
	FY15	FY16	FY17	FY18E	FY19E
Profit/(Loss) before tax	**(53,439)**	**(8,857)**	**353**	**NA**	**NA**
Depreciation, amortisation and impairment (2)	52,374	431	270	NA	NA
Change in working capital	7,230	(799)	304	NA	NA
Others	2,427	7,928	1,709	NA	NA
Net Cash from/ (used in) operations	**8,592**	**(1,297)**	**2,636**	**NA**	**NA**
Capital Expenditures	(8,501)	(332)	(3,309)	NA	NA
Others	650	139	(1,921)	NA	NA
Net Cash from/(used in) investing	**(7,851)**	**(193)**	**(5,230)**	**NA**	**NA**
Net increase in equity	1	-	100	NA	NA
Net increase in debt	3,000	(4,476)	658	NA	NA
Others	(4,327)	(2,080)	1,165	NA	NA
Net Cash from/(used in) financing	**(1,326)**	**(6,556)**	**1,923**	**NA**	**NA**

(2) The decline in both crude oil prices and production levels gave rise to an overall impairment charge on the producing oil and gas properties in FY15.

Ratios

	Fiscal Year Ended				
	FY15	FY16	FY17	FY18E	FY19E
Profitability (%)					
Gross profit margin	(45.3%)	36.7%	55.2%	NA	NA
Profit/(loss) before tax margin	(222.7%)	(51.3%)	10.8%	NA	NA
Profit/(loss) after tax margin	(227.9%)	(58.4%)	3.1%	NA	NA
Liquidity (x)					
Current ratio	1.5	1.5	1.1	NA	NA
Quick ratio	1.3	1.3	0.9	NA	NA
Interest coverage ratio	(890.8)	(93.4)	10.3	NA	NA
Net Debt to Equity	(48.0%)	(37.8%)	(33.3%)	NA	NA
Valuation (x)					
P/S	1.5	2.4	3.2	NA	NA
P/E	NA	NA	10.4	NA	NA
P/B	0.6	0.8	0.7	NA	NA
Cash Conversion Cycle					
Net trade receivable days	52	87	107	NA	NA
Inventory days	65	132	282	NA	NA
Trade payable days	65	41	97	NA	NA
CCC days	48	193	276	NA	NA
Returns					
Return on equity	(162.4%)	(37.5%)	5.8%	NA	NA
Return on capital employed	(141.1%)	(32.9%)	1.3%	NA	NA
Dividend payout ratio	NA	NA	NA	NA	NA

n.m.: not meaningful

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