Finncap Report dated 1 October 2020

Savannah Energy – Back on the front foot (SAVE, 10.7p , mkt cap £94m, EV £425m)

- **H1 results demonstrate Savannah's transformation into a highly cash generative business**
- **8M revenue hits US$133m and is on track for FY20 guidance of over US$200m**
- **Gas sales volumes and prices are rising, with US$ gas contracts underpinned by World Bank guarantees**
- **H1 pro-forma EBITDA more than doubled to US$67m**
- **Strong free cash flow generation allows debt reduction and, over time, distributions.**

Savannah's latest update should go some way to assuaging investors that have been frustrated by the lack of communication over the last several months. Yesterday's interim results and trading update clearly demonstrate the promised transformation following the Seven Energy transaction. Savannah is now a highly cash generative business with US$133m (+28% y/y) of cash collections in the 12m to end-August from its Nigerian gas business, on track for its reiterated its FY20 revenue guidance of US$200m+.

This is not a passing fad either. Over 94% of this revenue is derived from US$-based gas sales agreements that are underpinned by World Bank guarantees and have an average contract life of 15 years. Moreover, gas sales to new customers are expected to start before year-end and additional contracts hopefully signed, so there's growth to come too at minimal cost – there's plenty of spare capacity in the gas infrastructure.

H1 cash collections in Nigeria jumped 48% to US$82m helped by a 22% y/y increase in gas production alongside higher average gas price realisations (+8% to US$3.9/mcf). Accugas' market share increased too as other gas suppliers struggled to meet nominations after OPEC oil quota restrictions impacted associated gas production. This helped H1 EBITDA more than double to US$67m relative to last year's pro-forma result.

Savannah also re-iterated its FY20 guidance for G&A and opex (US$68-72m) and capex (up to US$45m). DD&A guidance has been cut to US$35-37m from US$43-45m due to an increase in the estimated useful life of the infrastructure. This points to a business that will throw off material free cash flow, which can be used not only to lower debt, but also pay distributions in time.

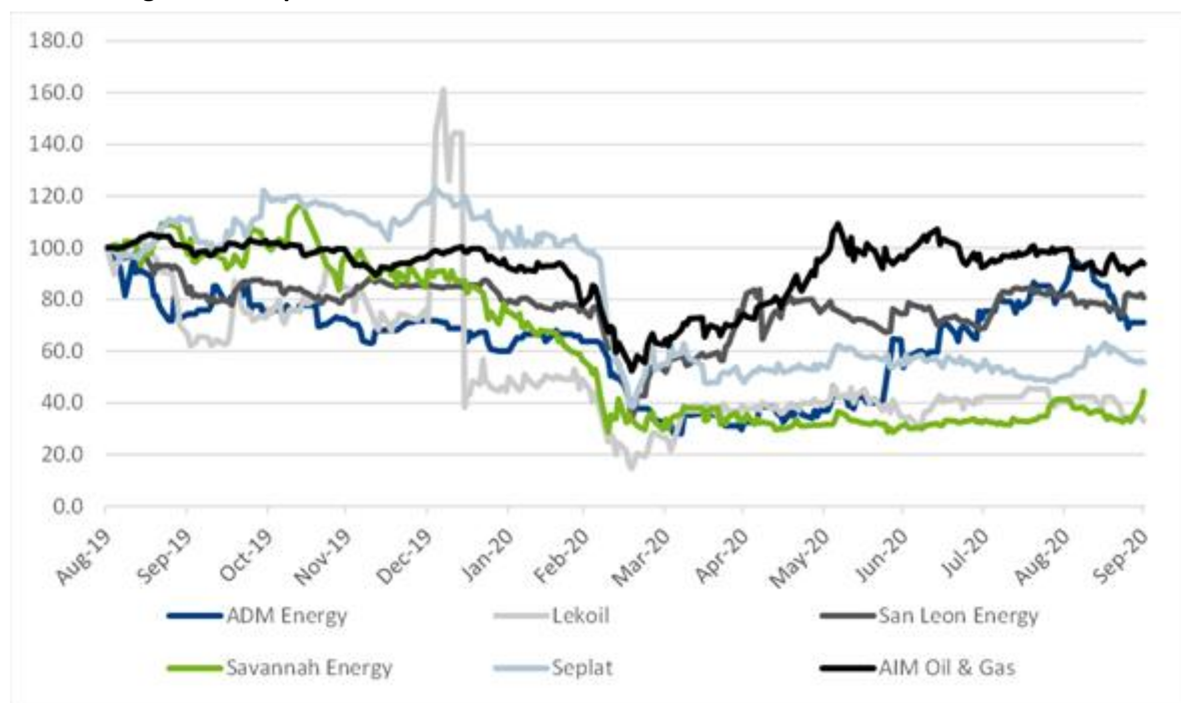
This was certainly supported by the H1 results. Operating cash flow of US$59m was reduced to US$46m after working capital moves. But, there was minimal H1 capex (<US$1m) and interest and finance fee payments of just US$21m, meaning the business generated US$23m of free cash flow, most of which was used to repay debt.

It would be wrong to annualise this as capex during the period was minimal and will ramp up materially in H2 (FY20 guidance up to US$45m), while interest was artificially low due to payment timings. Still, back of the envelope calculations suggest Savannah can generate over a 10% free cash flow yield. Moreover, this should improve going forward as infrastructure utilisation rates rise and unit costs reduce. Plenty of flexibility then to manage the balance sheet and consider distributions.

Outside of nonspecific 'Nigeria' anxiety (the population and industry still need gas and power!), investors biggest concerns have revolved around the lack of communication and debt levels. In reality, Savannah's extended close period was not of its own doing and since FY19 results it has put out a bumper Annual Report and delivered H1 results and a trading update, all within the last two months. With the Seven Energy transaction behind it, expect this recent trend to continue.

Current debt stands at around US$511m (net debt US$427m) – remember the debt was negotiated down from over US$1bn during the Seven Energy transaction. This debt is linked to the Accugas midstream gas assets, so is non-recourse to Savannah. More importantly, Savannah now has World Bank guarantees covering its gas sales, so getting paid shouldn't be an issue. The debt is also falling (down US$18m in H1) and Savannah can comfortably manage the interest payments. Ultimately the ambition is to refinance the debt, the majority of which is paying 10.5% over US Libor. In the meantime, Savannah gets to enjoy the benefits of a US$1bn gas business in a high growth market.

Relative Nigerian E&P performance



These results are not in keeping with the stock's performance in recent months. Prior to yesterday's 12% bounce the shares were down over 50% on the year and the worst performer amongst its Nigerian peers. As the market wakes up to the cash emanating from the Seven Energy assets, that will change.

Management are certainly backing themselves, with the Directors buying 11m shares (>1% outstanding) as soon as the company came out of its close period in August. Not to leave any stone unturned, it has also published its first sustainability report and intends developing and implementing a new ESG performance reporting framework.

Oh, and I haven't even mentioned Niger, where they have a 100% exploration success rate and 146 additional leads and prospects. Yeah but, no but…