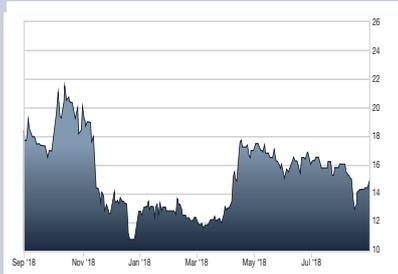




Oil & Gas



Source: LSE

Market Data

EPIC	TXP
Current Share Price	15p
52 Week High	22.5p
52 Week Low	10.25p
30MA Volume	173,237
Market Cap	£24m
Shares in issue	161m
Market	AIM & TSXV

Description

Touchstone Exploration is a Canada-based upstream oil and gas company active in the Republic of Trinidad and Tobago. It holds more than 8,700 WI acres of onshore producing properties with known crude oil reserves and more than 55k of exploration WI acres that are being evaluated.

Directors & Company Info

Paul Baay, President & Chief Executive Officer
 Scott Budau, Chief Financial Officer
 James Shipka, Chief Operating Officer

Contact

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Touchstone Exploration: Exciting times ahead as company 'shifts focus towards higher impact exploration'

Since joining AIM in summer 2017, Touchstone Exploration (LSE:TXP) has significantly increased oil production across its portfolio of assets in Trinidad & Tobago. During this time, the company has focussed on building a strong, cash-generative foundation through drilling lower risk wells. The strategy has paid off and in the first half of 2019 Touchstone created free cash flow of \$3.7m.

To build on this success the firm's directors have turned their attention to the business' larger exploration projects and have initiated a drill campaign targeting three separate high impact wells. The first of these, Coho-1, is already underway and the second, Cascadura-1, is scheduled to spud in mid-September. In anticipation of this Touchstone's broker, Shore Capital, has recently released a broker note, in which it says it sees "considerable value in this full-cycle operator, in addition to a compelling risk/reward profile on the exploration side."

Laying a firm foundation

In its results for the three and six months ended June 30, [released on 14 August](#), Touchstone reported that its daily production rate averaged 1,944bbls/d in the first half of 2019. A great deal of this volume came from the numerous development wells drilled by the company across its Coora-1, Coora-2, WD-4, and WD-8 fields in the south-east of Trinidad last year.

Although half year output was down on the 2,121bbls/d average posted in Q1, Touchstone had previously warned a decline might arise from an optimisation programme that led it to take several wells offline throughout the majority of Q2. Putting this to one side, the firm's H1 2019 production rate still represented a healthy 19pc increase on the equivalent figure it posted in its H1 2018 results.

Production has since remained steady in the 1,900bbls/d range and with no more development wells until 2020, Shore Capital expects Touchstone to focus solely on preserving its base production. The broker believes the firm will achieve this by carrying out further optimisation and recompletion activities throughout the rest of 2019, at an estimated annual cost of \$1.5m. With the cash flow Touchstone continues to generate from these assets, this expenditure will be covered by internally generated funds.

With this in mind, Shore Capital anticipates that production will remain around current levels until next year and has cut its forecast year-end production rate from 2,200bbls/d to 1,875bbls/d to reflect this. Although this may sound like a significant cut, the broker expects this figure to shoot back past the 2,000bbls/d market to 2,300bbls/d in 2020 when development drilling recommences. Indeed, it expects Touchstone to drill ten new well across Coora-1, Coora-2, WD-4, and WD-8 for \$1m each throughout the year.

‘Potentially transformational production impact’

In the absence of any development drilling this year, Touchstone’s focus has moved onto exploration drilling in recent months. The business’s efforts centre around its high-impact, 35,786-acre Ortoire exploration block on the east side of Trinidad.

As revealed [earlier this year](#), Ortoire lies on turbidites-deep deposits formed by massive gravity flows down the offshore continental shelf and slope that, over time, can turn into vast hydrocarbon reserves.

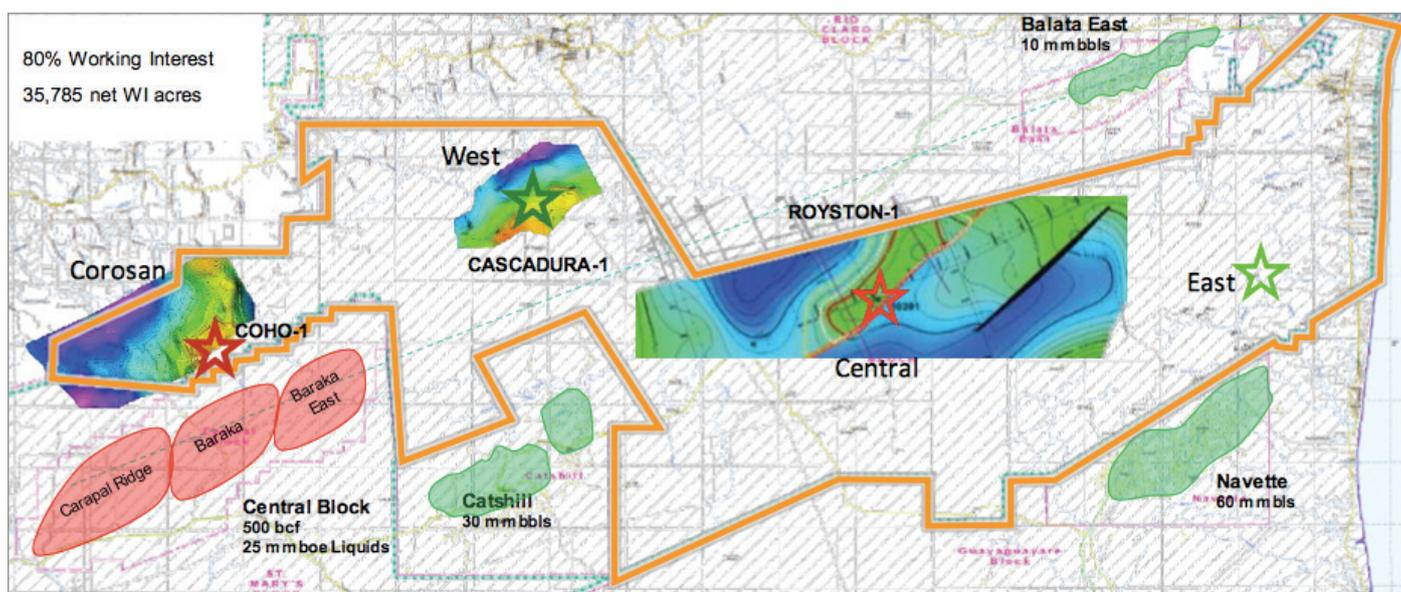
Importantly, as oil and gas firms did not begin to focus on turbidites until the 1970/80s, they have often been left untapped in previously explored areas, creating substantial new potential.

Touchstone owns an 80pc working interest in Ortoire. However, it is responsible for all drilling, completing, and testing costs at the asset, as agreed under a deal with state oil company Heritage.

As it stands, the block contains four general prospects called Corosan Gas, Ortoire West (Cascadura) Oil, Ortoire Central (Royston) Gas, and Ortoire East Oil. Touchstone has used these blocks to define 11 drilling locations, four of which will be the subject of initial exploration drilling campaign over this year and next.

These first targets span the Corosan, Cascadura, and Royston fields, which contain contingent and prospective resources of c.22MMboe net to Touchstone according to an evaluation by GLJ Petroleum Consultants (GLJ).

Ortoire Block



Source: Touchstone Exploration Plc

Coho-1 – an exploration well ‘only in name’

On 8 August, Touchstone took a much-anticipated step forward at Ortoire when it spudded its first exploration well on the block – Coho-1. The well is located on Corosan and just north of Shell’s 500bcf Carapal Ridge discovery, Trinidad’s largest onshore gas/condensate discovery in 50 years. It is also up-dip of the historic Corosan-1 well, which successfully tested the same zones being target by Touchstone at a rate of 8mmcf/d.

Specifically, Touchstone is targeting gas prospects in the Herrera formation at depths of 5,200-8,500ft as well as a deeper and previously untested Top Herrera zone that it considers prospective based on 3D seismic. The firm estimates that Corosan’s shallow zones contain 10.6bcf of net contingent res of 10.6bcf while it believes that the prospect’s deeper zones could house a further 6.1bcf.

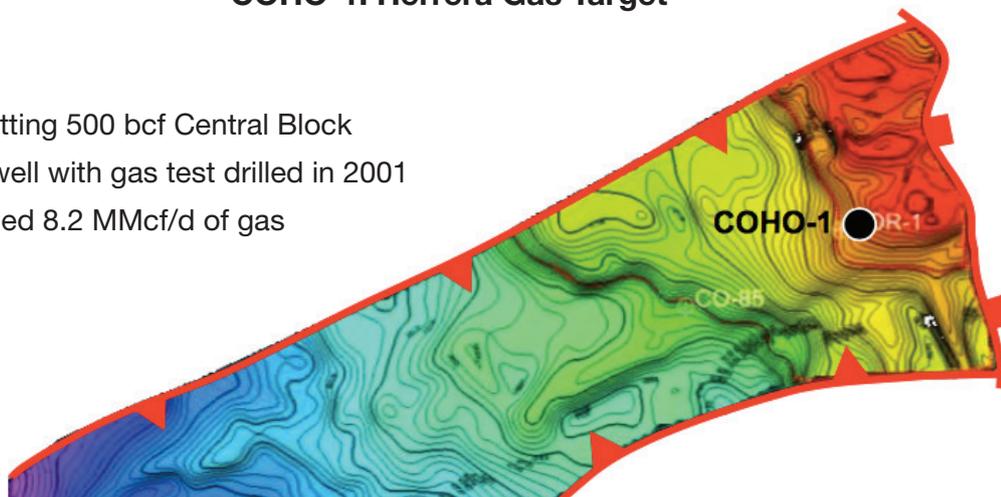
The drilling of Coho-1 will take around 28 days to complete at an estimated cost of \$3m (\$4m once completion is included), with a progress update expected by mid-September. Although Corosan’s total unrisks resources account for only c.15pc of Ortoire total resource volumes, Shore Capital said September’s update could be a ‘genuinely transformational event’ for Touchstone.

This is because Coho-1 is effectively an appraisal of an existing discovery (Corosan-1) and is only an exploration well in name. As Shore Capital highlighted, GLJ’s resource assessment reflects this point, assuming a 100pc chance of discovery and a 95pc chance of development for resources at the well. As such, the broker said Coho-1 presents a ‘*compelling risk/reward profile*’ and will have a powerful de-risking effect on the more comprehensive Ortoire block, adding:

“ We believe [a commercial discovery with Coho-1 would provide] the opportunity for early monetisation via a 3.5km tie-in to Shell’s existing gas processing facility at Carapal Ridge, diversification beyond Touchstone’s existing liquids production and strong validation of the wider potential across the Ortoire block. ”

COHO-1: Herrera Gas Target

- Offsetting 500 bcf Central Block
- Key well with gas test drilled in 2001
- Gauged 8.2 MMcf/d of gas



Source: Touchstone Exploration Plc

Once Touchstone drills and completed Coho-1, it plans to drill two wells at Cascadura – both targeting oil – and a gas well at Royston. One of these will follow Coho-1 in 2019 while the third and fourth are slated for 2020. Like Coho-1 – all three are expected to cost around \$4m in total and are considered to have a high chance of success due to being adjacent to existing discoveries and Touchstone’s existing storage facilities. As such, Shore Capital says the Ortoire drilling programme as a whole offers ‘*straightforward monetisation*’ to Touchstone in the success case, adding:

“ We see the opportunity for Touchstone to more than triple its existing production if all four Ortoire wells deliver as hoped. ”

Future Financial Upside

Moving away from drilling, August also saw Touchstone reveal a healthy set of financials in its interim results. In the first six months of 2019, the business generated \$20.7m translating into profit before tax of \$3.5m. However, as in the previous financial period, tax charges led the company to report an overall net loss of \$1m.

Meanwhile, net debt sat at a \$10m as at 30 June alongside unrestricted cash of \$7.25m – a figure that decreased only marginally from \$7.6m at end-March.

Shore Capital praised Touchstone’s prudent use of cash of late, with capex coming in at just \$1.8m throughout the first half due to the suspension of drilling.

Shore Capital Estimated Valuation

	Unrisked US\$m	CoS* %	Risked US\$m	Unrisked US\$/share	Risked US\$/share	Risked £/share
Proved producing	36.3	100	36.3	0.22	0.22	0.17
Proved non-producing	11.9	70	8.3	0.07	0.05	0.04
Proved undeveloped	30.4	60	18.2	0.18	0.11	0.09
Total probable	56.4	50	28.2	0.34	0.17	0.13
Total possible	43.9	30	13.2	0.26	0.08	0.06
Warrants and options	1.2	100	1.2	0.01	0.01	0.01
Forecast net debt (FY '19F)	(11.5)	100	(11.5)	(0.07)	(0.07)	(0.05)
PV central costs	(39.8)	100	(39.8)	(0.24)	(0.24)	(0.19)
Core NAV	128.7	-	54.1	0.77	0.32	0.26
Ortoire contingent	21.0	30	6.3	0.13	0.04	0.03
Ortoire prospective	131.6	10	13.2	0.78	0.08	0.06
Total NAV	281.3	-	73.5	1.68	0.44	0.35

Source: Touchstone Exploration Plc & Shore Capital

It said this would allow the business to 'press on confidently' with planned exploration drilling at Ortoire throughout the remainder of the year, adding:

“ Ahead of results from the first two Ortoire exploration wells, we do not currently factor in the cost of the two follow-on wells planned at Ortoire in FY2020. With its C\$15m term credit facility successfully extended, we expect Touchstone to begin to test the limits of available headroom (in terms unrestricted cash) towards the end of this year, but basically see the current year's work programme as more-or-less fully funded. ”

To reflect these recent interim figures, Shore Capital also updated its performance forecasts for Touchstone in FY2019 as well as introducing estimates for FY2020. In making these calculations, the broker has assumed a benchmark Brent price of \$65/bbl throughout both years, with Touchstone selling at an 11.5pc discount (\$58/bbl). Both of these figures represent a small discount to the six-month numbers reported in the company's interim results. Meanwhile, Shore Capital has also forecast operating expenses of \$15/bbl (\$14.52/bbl in H12019) and an operating netback of \$26bbl (\$28.20 in H1 2019) for the period.

Once it has factored in its production downgrade and other adjustments, the broker expects the company to post a \$2m adjusted net loss this year. It believes that this net loss will then increase to c.\$3.7m in FY2020, reflecting the firm's increased exploration spend. However, it also expects to see a healthy improvement

in operating cash flow to more than \$7.5m in FY2020 from c.\$2.m in FY2019 as production once again ramps up.

Elsewhere, Shore Capital said that the results of drilling at Ortoire would determine Touchstone's main funding requirements through end-2020. If both of this year's wells come in as dusters, it expects dry hole costs are expected to total \$6m, providing adequate headroom through the end of FY2019. However, the broker expects Touchstone to command a 'much higher' share price if one or more of its wells are successful. It said this would then leave the firm 'strongly placed' to evaluate funding options to support follow-on growth such as equity, debt, or industry alternatives.

The broker added:

“ We are therefore relatively relaxed about Touchstone's funding position and believe that the likelihood of future drilling success will be the major consideration for investors in the coming months. ”



Market undervaluing Ortoire

From a valuation perspective, the Shore Capital core and risked NAV estimates for Touchstone come in at 26p and 35p respectively – with the latter remaining unchanged. With a current share price of 14.55p, the business is currently trading at a considerable discount to both of these figures. As such, the broker called the firm's current share price a '*compelling entry point*' ahead of the announcement of the results of the first Ortoire well, adding:

“ The corollary of this approach is the scope for a significant NAV upgrade if unrisks potential is successfully realised with the drill-bit at Ortoire. Corosan (where the maiden Coho-1 well is being drilled) accounts for ~15% of total assessed Ortoire volumes. Therefore, even before accounting for the de-risking effect on the wider block, we would expect a successful first (or second) Ortoire well to act as a powerful catalyst. ”

Finally, looking ahead, Shore Capital concluded that, on a fully unrisks basis, it sees the potential for the three main Ortoire prospects to add an impressive c.60p/share to its 35p/share risked NAV estimate for Touchstone.

The broker said:

“ Ultimately, future share price performance will depend on drilling results and, in this context, we would emphasise the fact that the chances of success are assessed to be high, with the prevailing share price more than underpinned by existing reserves and our risked NAV estimate indicating considerable running room. ”

Having already laid down the foundations of a successful balance by way of an aggressive development drilling programme in 2018, Shore Capital's outlook indicated a highly bright future for Touchstone. With both development and high potential exploration completing between by end-2020, the firm offers both funding requirement flexibility and the potential for much upside from its current £24m market cap.

Touchstone's assets in summary

Scalable Economic Growth

Ten developed and producing blocks

- 7,910 net working interest acres
- Total Proved Reserves of 11,222 Mbbls(1)
- Total Proved + Probable Reserves of 19,275 Mbbls(1)

Exploration Upside

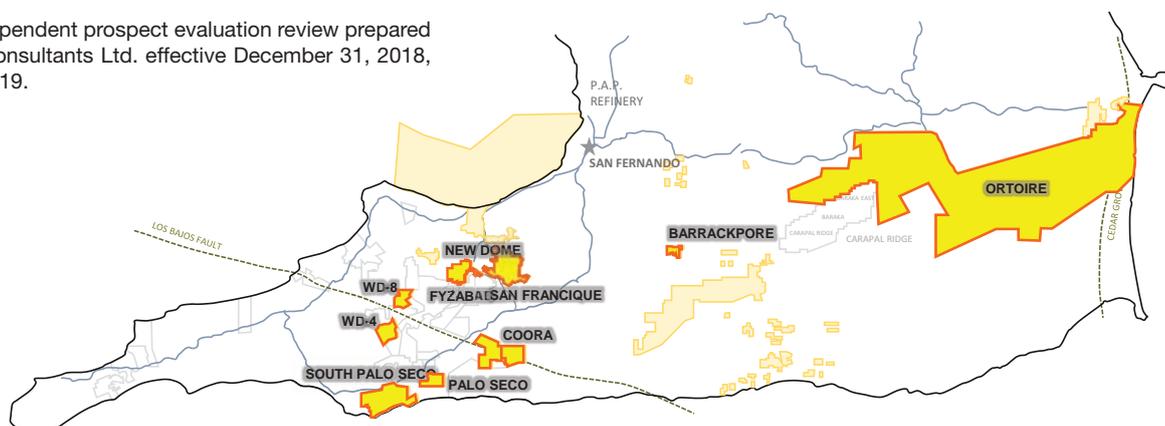
Nine undeveloped or exploration blocks

- 54,297 net working interest acres
- BECR of 3,002 Mboe (unrisked) and 2,852 Mboe (risked)(2)
- BECR of 18,801 Mboe (unrisked) and 6,385 Mboe (risked)(2)

*BECR = Best Estimate Contingent Resources

(1) Based on December 31, 2018 GLJ Petroleum Consultants Ltd. independent reserves evaluation.

(2) Based on the independent prospect evaluation review prepared by GLJ Petroleum Consultants Ltd. effective December 31, 2018, dated January 16, 2019.



Source: Touchstone Exploration Plc

Disclaimer

Author: Daniel Flynn

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