InPlay Oil

Tempering 2024 and 2025 Expectations; Rating Remains an Outperform

Oct 07, 2024

Nat Resources

IPOOF

OTCQX

Rating

Outperform

Unchanged

Current Price

$1.55

Target Price

$5.50

Market Capitalization
139.4M

Shares Outstanding
90M

Float
87M

Institutional Holdings
1.5%

12-Month Low/High
$1.42/$2.07

Average 90-Day Volume
39970

Fiscal Year End
12/31/2024

Revenues ($ MIL)

Period	2022A	2023 A	2024 E
Q1	52.156 A	45.301 A	37.997 A
Q2	71.287 A	39.762 A	41.460 A
Q3	56.985 A	46.672 A	34.392 E
Q4	58.161 A	47.631 A	44.242 E
	238.590 A	179.366 A	158.090 E

EPS ($)

Period	2022 A	2023 A	2024 E
Q1	0.21 A	0.11 A	0.02 A
Q2	0.33 A	0.05 A	0.06 A
Q3	0.17 A	0.08 A	0.00 E
Q4	0.21 A	0.13 A	0.05 E
	0.92 A	0.36 A	0.13 E

Lower third quarter commodity prices. During the third quarter, West Texas Intermediate (WTI) crude oil prices declined 18.2% to $68.17 per barrel and averaged $75.35 per barrel. InPlay sells oil at monthly average Edmonton Par prices which are based on the price of WTI crude oil minus quality differentials, transportation, and marketing fees. Crude oil prices have risen since the end of the quarter due to heightened geopolitical risk with WTI crude oil priced at $74.45 per barrel on October 4. WTI and Henry Hub futures prices average $71.16 per barrel and $3.40 per mcf in 2025. We note that natural gas prices in Canada were weak relative to Henry Hub prices during the third quarter.

Outlook for 2025. For 2024, the company forecast average production of 8,700 to 9,000 barrels of oil equivalent per day (boe/d). We are forecasting 2024 production of 8,682 barrels of oil equivalents per day compared to our previous estimate of 8,952 boe/d due to lower third and fourth quarter expectations. We think the company may start off with a conservative 2025 plan that targets production at the upper end of 2024 guidance and have lowered our production expectations to 8,971 from 9,638 barrels of oil equivalents per day.

Lowering estimates. We have lowered our 2024 adjusted funds flow (AFF) and EPS estimates to C$76.7 million and C$0.13, respectively, from C$83.9 million and C$0.18. Our new estimates reflect lower production and commodity prices. While we have lowered our expectations, the fourth quarter should be relatively strong. We note our 2024 adjusted funds flow estimate is below the company's guidance range of C$80 million to C$85 million. We also lowered our 2025 AFF and EPS estimates to C$93.5 million and C$0.25 from C$99.7 million and C$0.27, respectively, to reflect lower capital spending and production compared to our prior estimates.

Rating remains Outperform. InPlay is a nimble operator and has an enviable track record of deftly adjusting to market conditions. While we have lowered our 2024 and 2025 our estimates, the equity is trading well below our fair value estimate. We think the current price represents an attractive entry point for investors.

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Refer to the last two pages for Analyst Certification & Disclosures

Tempering 2024 and 2025 Expectations; Rating Remains an Outperform

For 2024, the company forecast average production of 8,700 to 9,000 barrels of oil equivalent per day (boe/d). We are forecasting 2024 production of 8,682 barrels of oil equivalents per day compared to our previous estimate of 8,952 boe/d due to lower third and fourth quarter expectations. We think the company may start off with a conservative 2025 plan that targets production at the upper end of 2024 guidance and have lowered our production expectations to 8,971 from 9,638 barrels of oil equivalents per day.

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When InPlay reported its second quarter financial results, management reported that it had finished drilling operations on a two horizontal Cardium well pad in Willesden Green with completion expected shortly. The company planned to drill four additional wells throughout the remainder of the year, including a minimum of three extended reach horizontal (ERH) wells in Pembina Cardium Unit 7. This area delivers strong oil rates and benefits from higher gas rates and lower overall decline rates.

While we think InPlay has finished its drilling program, well completions are ongoing. The company expects to benefit from higher winter gas pricing although AECO natural gas prices have diverged from Henry Hub and remain weak. We trimmed our third and fourth quarter production estimates to 8,238 and 9,230 barrels of oil equivalent per day, respectively, from 8,391 and 10,155 boe/d. Of this, we forecast third and fourth quarter crude oil production of 3,300 and 4,000 barrels per day, respectively. Relatively strong production in the fourth quarter coupled with a limited capital program should support strong free adjusted funds flow. Our full year 2024 and 2025 production estimates are 8,682 and 8,971 barrels of oil equivalent per day, respectively.

In connection with its November 2021 acquisition, InPlay acquired producing and undeveloped acreage within a delineated Glauconite light oil play at Willesden Green. The company has identified 12 locations which could provide the potential for material production growth. InPlay anticipates returning to drill within the Glauconite pool prior to the end of the first quarter of 2025.

Capital Expenditures and Liquidity

In June, InPlay Oil renewed its senior credit facility with a borrowing base of C$110 million that is comprised of a C$95 million revolving facility and a C$15 million operating line of credit. The term out date was extended to June 30, 2025, with a maturity date of June 30, 2026. As of June 30, the company had drawn C$54.6 million on the credit facility.

Capital expenditures in 2024 are expected to be in the range of C$64 million to C$67 million. Minimal spending is planned for the fourth quarter. During the first six months of 2024, the company spent C$30.9 million on property, plant, and equipment, and C$0.8 million on exploration and evaluation. The Company drilled, completed and brought on production two (1.9 net) extended reach horizontal ("ERH") wells in Willesden Green, three (3.0 net) ERH wells in Pembina and three (0.65 net) non-operated Willesden Green ERH wells during the first quarter of 2024. The Company also drilled one (1.0 net) Belly River well during the second quarter of 2024 which is expected to be on production in the third quarter and started drilling one (1.0 net) Willesden Green Glauconite well in June.

Company Profile

InPlay Oil is a junior oil and gas exploration and production company with operations in Alberta focused on light oil production. The company operates long-lived, low-decline properties with drilling development and enhanced oil recovery potential as well as undeveloped lands with exploration possibilities. The common shares of InPlay trade on the Toronto Stock Exchange under the symbol IPO and the OTC Exchange under the symbol IPOOF.

Fundamental Analysis

Our fundamental assessment rating, separate from our investment rating and valuation, is based on five attributes. We assign InPlay 4.0 checks out of a possible 5.0 checks. In our opinion, the company's corporate governance practices are shareholder friendly with the company's board of directors being comprised of five independent members in addition to InPlay's CEO, Douglas Bartole. The board is diverse, with differing financial and operational backgrounds. We believe InPlay's management team is strong with a long history of operating energy assets in Western Canada. InPlay faces a favorable market opportunity given high energy prices. InPlay is a low-cost producer with ample growth opportunities putting it in a good competitive position relative to other western Canadian energy companies. An efficient operating structure grants the company significant operating leverage to rising revenues. We view the company's financial leverage positively following recent deleveraging and liquidity improvements. InPlay's liquidity is adequate. For further explanation of our fundamental analysis, refer to disclosures at the end of this report.

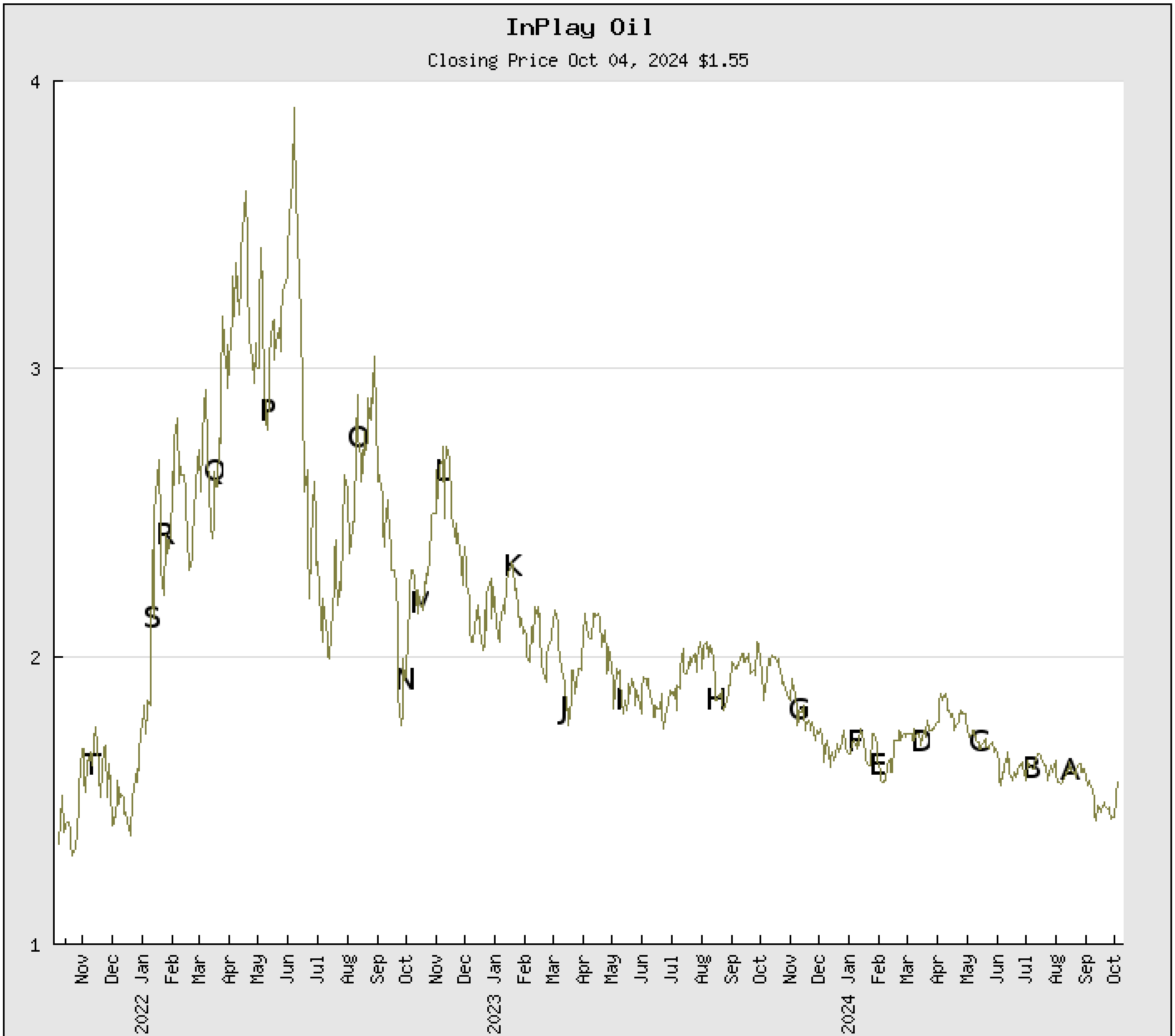
Valuation Summary

Our price target on the shares of IPOOF is $5.50 per share. Our price target is based on a two-stage discounted cash flow model that uses a discount rate of 10.0% and a long-term growth rate of 2.5%. Our price target on the shares of IPOOF equates to a price target of C$7.35 for the shares of IPO on the Toronto exchange. Due to fluctuations in exchange rates, we have employed a baseline exchange rate of US$0.75 per C$1.00.

Risks Include: changes in commodity prices including widening spreads between location pricing and index pricing, drilling results, well performance, changes in operating costs, difficulties in obtaining financing and stock market liquidity.

InPlay Oil Corp.
CAN $ thousand
FY End - December

Income Statement	2021A	2022A	2023A	Mar	June	Sep	Dec	2024E	Mar	June	Sep	Dec	2025E
Income Statement													
Revenues	113,854	238,590	179,366	37,997	41,460	34,392	44,242	158,090	42,940	43,417	43,894	43,894	174,144
Revenues, less royalties & deriva	90,179	196,042	158,820	32,904	37,722	29,815	38,354	138,794	37,225	37,638	38,052	38,052	150,968
Cash Operating Costs	(43,913)	(58,544)	(65,067)	(15,319)	(15,672)	(14,317)	(15,836)	(61,144)	(13,080)	(14,675)	(14,858)	(14,908)	(57,520)
Noncash Operating Costs	32,922	(45,434)	(51,400)	(12,818)	(12,489)	(12,133)	(13,502)	(50,942)	(13,180)	(12,836)	(13,138)	(13,147)	(52,302)
Gain on sale	18,666	0	0	0	0	0	0	0	0	0	0	0	0
Other Expenses	0	0	0	0	0	0	0	0	0	0	0	0	0
Operating Income	97,854	92,064	42,353	4,767	9,561	3,365	9,016	26,709	10,965	10,128	10,056	9,997	41,146
Interest Expense	(6,747)	(6,459)	(8,386)	(2,522)	(2,515)	(2,815)	(2,715)	(10,567)	(2,715)	(2,715)	(2,715)	(2,715)	(10,860)
Pretax Operating Inc.	91,107	85,605	33,967	2,245	7,046	550	6,301	16,142	8,250	7,413	7,341	7,282	30,286
Income Taxes Expense (Gain)	23,964	(1,710)	(1,265)	(559)	(1,631)	(126)	(1,449)	(3,766)	(1,898)	(1,705)	(1,688)	(1,675)	(6,966)
Earnings for Common	115,071	83,895	32,702	1,686	5,415	423	4,852	12,376	6,353	5,708	5,652	5,607	23,320
Avg. Common Shares	71,473	91,137	90,616	90,195	93,213	93,446	93,679	94,681	93,773	94,776	93,867	94,870	94,681
Adjusted EPS	$ 0.74	$ 0.92	$ 0.36	$ 0.02	$ 0.06	$ 0.00	$ 0.05	$ 0.13	$ 0.07	$ 0.06	$ 0.06	$ 0.06	$ 0.25



A - 08/16/2024 Outperform Target $6.00 Current $1.60	B - 07/08/2024 Outperform Target $6.00 Current $1.61
C - 05/13/2024 Outperform Target $6.00 Current $1.70	D - 03/14/2024 Outperform Target $6.00 Current $1.70
E - 01/31/2024 Outperform Target $6.00 Current $1.62	F - 01/09/2024 Outperform Target $6.00 Current $1.71
G - 11/10/2023 Outperform Target $6.00 Current $1.81	H - 08/16/2023 Outperform Target $6.00 Current $1.85
I - 05/15/2023 Outperform Target $6.00 Current $1.85	J - 03/16/2023 Outperform Target $6.00 Current $1.82
K - 01/19/2023 Outperform Target $6.00 Current $2.31	L - 11/10/2022 Outperform Target $6.00 Current $2.65
M - 10/14/2022 Outperform Target $6.00 Current $2.19	N - 09/29/2022 Outperform Target $6.00 Current $1.92
O - 08/12/2022 Outperform Target $6.00 Current $2.76	P - 05/12/2022 Outperform Target $6.00 Current $2.85
Q - 03/17/2022 Outperform Target $6.00 Current $2.64	R - 01/26/2022 Outperform Target $3.00 Current $2.42
S - 01/13/2022 Outperform Target $3.00 Current $2.13	T - 11/11/2021 Outperform Target $3.00 Current $1.62

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The fundamental assessment rating system is designed to provide insights on the company's fundamentals both on a macro level, which incorporates a company's market opportunity and competitive position, and on a micro/company specific level. The micro/company specific attributes include operating & financial leverage, and corporate governance/management. The number of check marks that a company receives is designed to provide a quick reference and easy determination of the company's fundamentals based upon the following five attributes of the company (weighting reflects the importance of each attribute in the overall scoring of company's fundamental analysis):

Attribute	Weighting
Corporate Governance/Management	20%
Market Opportunity Analysis	20%
Competitive Position	20%
Operating Leverage	20%
Financial Leverage	20%

For each attribute, the analysts score the company from a low of zero to a high of ten based upon the analysis described below. The final rating and resulting check marks is a result of dividing the overall score (out of 100%) by ten.

Rating	Score	Checks
Superior	9.1 to 10	Five Checks
Superior	8.1 to 9	Four & A Half Checks
Above Average	7.1 to 8	Four Checks
Above Average	6.1 to 7	Three & A Half Checks
Average	5.1 to 6	Three Checks
Average	4 to 5	Two & A Half Checks
Below Average	3 to 3.9	Two Checks
Below Average	2 to 2.9	One & A Half Checks
Low Quality	0 to 1.9	One Check

While these are the attributes currently used for the analyst's fundamental analysis, the attributes and weighting may be reviewed, updated with additional attributes, and/or changed in the future based on discussions with the analysts and recommendations from the Director of Research.

Following is the description of each attribute in the fundamental analysis.

Corporate Governance/Management

We believe that a review of corporate governance and assessment of the senior management are important tools to determine investment merit. Good corporate governance aligns management with the interests of stakeholders. As such, analysts are to rank the company on the basis of good corporate governance principles that may include rules and procedures, board composition and staggered term limits, rights and responsibilities, corporate objectives, monitoring of actions and policies, and accountability. In addition, analysts will assess issues with controlling shareholders and whether decisions have been made in the past that were in the interests of all shareholders. In addition, management will be assessed based on industry experience, expertise, and/or track record.

High ranking example: Board and management that is aligned with the interests of shareholders with incentives based on stock price appreciation and with an experienced management team known for exceptional shareholder returns.

Low ranking example: Concentrated ownership without independent directors that do not necessarily align with all shareholders' interests.

The Market Opportunity Analysis

In this review, the analyst assesses the company's macro environment as a measure of understanding the industry. Factors considered include the size and growth potential of the industry under various economic conditions, the emerging demands in the market, technological benefits/disruptions, competition, geographical opportunities, and customer demands/needs, and an assessment of supply and distribution channels. In addition, the analyst will review legal and regulatory trends, as well as potential shifts in consumer or social behavior and natural environment changes.

High rank example: A company in an industry that is growing revenues well above GDP rates (which are on average 2% plus) and/or may have unmet or under-served needs in a rapidly growing market opportunity.

Low rank example: A mature industry that is in secular decline and likely to grow below GDP rates.

Competitive Position

The evaluation of the company's competitive position is another macro environment attribute designed to measure the relevance, market share, position and value proposition, and sustainable differentiations of the company and its products/services within its industry. Ease of entry into the industry and the ability of other well-funded players to potentially enter the market would be determined. As such, the assessment would consider the company's strengths and advantages of its products/services against weaknesses and limitations. This may include the company's current brand awareness, pricing and cost structure, current market strategies and geographic penetration that may affect demand for its products/services. In addition, the company's competitors would be evaluated.

High rank example: An analyst would consider the company's product to be superior to its competitors and that should allow the company to gain market share.

Low rank example: A company with a "me-too" product that does not have any significant technology advantages in an industry that has low barriers to entry.

Operating Leverage

Simplistically, operating leverage is determined by the operating income relative to changes in revenue. The analyst will calculate the impact on sensitivity on gross margins and variable costs to determine operating leverage. The analyst will take into account the ability of the company to cut fixed and variable costs in a challenged revenue environment and technological changes that may impact operating expenses. In addition, the analyst is to assess corporate strategies that include capital investment, which may be required for sustainable revenue growth, marketing expenses, and the company's ability to attract and retain talent and/or employees. The analyst should focus on the revenue opportunity and determine the price elasticity of demand for the company's products or services. In other words, the analyst is to rank the company based on improved operating margins going forward on an absolute and relative basis.

High rank example: A company that has improving margins for the foreseeable future, with significant price elasticity.

Low rank example: A company that is in a challenged revenue environment with a fixed cost structure and limited ability to cut costs, indicating an outlook for declining margins.

Financial Leverage

A strict definition of financial leverage is total debt divided by total shareholder's equity. Financial leverage analysis is to determine the company's ability to improve shareholder value by means of utilizing its balance sheet to grow organically or to acquire assets. Analysts may look at the company's debt to cash flow leverage ratio, interest coverage ratios, or debt to equity ratios. In addition, the interest rate environment and the outlook for interest rates are a factor in determining the company's ability to manage financial leverage. Finally, the analyst is expected to determine the ability to service the debt given the industry and/or company profile, such as cyclicality, barriers to entry, history of bankruptcy, consistency in revenue and profit growth, or predictability in sales and profits and large cash reserves. The analyst is expected to take into account capital intensity of the company and the anticipated of capital allocation decisions.

High rank example: A company with predictable and growing revenue and cash flow with modest debt levels. This may indicate that the company could improve shareholder value through growth investments, including acquisitions, using debt financing.

Low rank example: A company in a cyclical industry in a late stage economic cycle that has above average debt leverage and is in an industry that has a history of financial challenges, including bankruptcies.

ANALYST CREDENTIALS, PROFESSIONAL DESIGNATIONS, AND EXPERIENCE

Senior Equity Analyst focusing on Basic Materials & Mining. 20 years of experience in equity research. BA in Business Administration from Westminster College. MBA with a Finance concentration from the University of Missouri. MA in International Affairs from Washington University in St. Louis.

Named WSJ 'Best on the Street' Analyst and Forbes/StarMine's "Best Brokerage Analyst."

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NOBLE RATINGS DEFINITIONS	% OF SECURITIES COVERED	% IB CLIENTS
Outperform: potential return is >15% above the current price	90%	25%
Market Perform: potential return is -15% to 15% of the current price	10%	3%
Underperform: potential return is >15% below the current price	0%	0%

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