

Hurricane Energy

Lancaster EPS funding in place

Fundraising

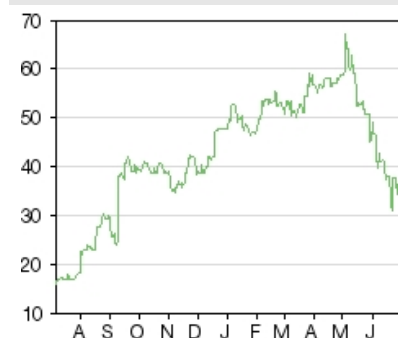
Oil & gas

4 July 2017

Price **32.50p**
Market cap **£399m**

Net cash (£m) at 31 December 2017e	235m
Shares in issues post fundraise	1,959m
Free float	53%
Code	HUR
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(28.2)	(42.7)	91.5
Rel (local)	(26.1)	(42.9)	68.2
52-week high/low		67.0p	16.0p

Business description

Hurricane Energy is an E&P focused on UKCS fractured basement exploration and development. It owns 100% of the 523mmmbbl (RPS 2P reserves plus 2C resources) Lancaster oil discovery, West of Shetland.

Next events

CPR	H217
Project sanction/FDP	Q317

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Hurricane has provisionally raised up to \$535m through a \$300m equity placing (plus \$5m follow-on offer) and a concurrent \$220m (with \$10m over-allotment) convertible bond offer. Equity is being placed at a price of 32p/share while the convertible offers investors a 7.5% coupon and conversion price of 40p/share – a 25% premium. We had assumed EPS funding in our valuation with an approximate 60/40 equity/debt split (see our May [Outlook](#) note); confirmation of funding should provide increased confidence in Hurricane's ability to keep to a H119 first oil target. The fall in Hurricane's share price over the last two months has led to greater dilution than we had previously anticipated with Edison's Lancaster NAV falling from 102p/share to 81p/share (c 21%) assuming convertible dilution.

Year end	Revenue (£m)	PBT* (£m)	Capex (£m)	Net cash** (£m)	Debt (£m)
12/15	0	(5.5)	(3.4)	9.9	0.0
12/16	0	(4.7)	(46.8)	82.2	0.0
12/17e	0	(5.7)	(72.1)	235.2	(175.8)
12/18e	0	(18.1)	(140.2)	77.0	(175.8)

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Dilutive impact of equity and bond placing

Our updated NAV includes the dilutive impact of Hurricane's equity and bond placing announced on 30 June 2017. We assume that a \$10m bond over-allotment option is exercised and an additional \$5m follow-on offer is completed successfully. The net result (alongside some modest changes to our FFD farm-out assumptions accounting for +4p/share) is a reduction in Lancaster NAV from 102p/share to 81p/share. Greater Lancaster Area (GLA) RENAV, including Halifax and Lincoln moves to 104p/share from 134p/share.

Activity expected in 2017/18

While Hurricane has concluded its 2016/17 exploration and appraisal campaign, we expect activity to centre on the Lancaster EPS final investment decision (FID), and the publication of a CPR encompassing Halifax and Lincoln, which is now expected towards the end of 2017. Farm-out discussions are likely to continue ahead of Lancaster EPS first-oil, a requirement to drive forward the Greater Lancaster Area appraisal and full-field development (FFD). We estimate that Hurricane will need to release a 51% equity interest in Lancaster in order to provide a farminee a 20% return at \$70/bbl long-term Brent while providing Hurricane with a full cost carry.

Valuation: oil prices weigh on sector

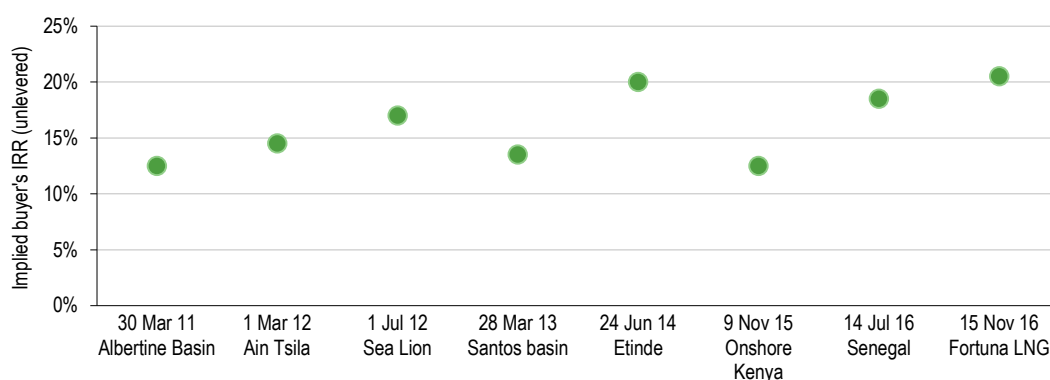
Recent oil price and share price volatility has not helped limit funding dilution, and one could expect full field development farm-out terms to be more onerous than we describe above if oil prices remain in-line with the current forward curve. Assuming static farm-out terms, our Lancaster NAV is 69.9p/share at 60\$/bbl and 58.4p/share at \$50/bbl Brent.

Valuation update

Hurricane Energy RENAV and oil price sensitivity

Our Hurricane RENAV is provided below, split into a core valuation, which includes the Lancaster EPS development (based on a 10-year field life), contingent upside for Lancaster full field development and prospective upside for Halifax and Lincoln. The net cash included in our valuation is post the fund raise and excludes Hurricane's convertible bond which we include in our diluted share count (ie assumes conversion at 40p/share). We assume full field development is funded via farm-down. We have modified our farm-out model from our last published [note](#), reducing the required farminee unrisks IRR from 25% to 20% at \$70/bbl Brent adding 4p/share to our Lancaster NAV. Post the delivery of a successful EPS development phase, we believe potential farminees will have greater confidence in FFD P50 returns and will be prepared to accept farm-in economic terms more in-line with that implied by recent sector transactions at 20% IRR.

Exhibit 1: Implied farminee/buyer IRRs from recent sector transactions



Source: Edison Investment research

Our relatively conservative assumptions with regard to capex cost and project timing remain unchanged from our last published note – here we assume an additional 10% cost contingency (which we expect to 'release' closer to first oil) and a first oil of early 2020.

Due to the effects of dilution and modest changes to our farm-out model, our Lancaster NAV falls by c 21% from 102p/share to 81p/share and our RENAV including Lincoln and Halifax upside falls by c 23% from 134p/share to 103p/share.

Exhibit 2: Hurricane Energy valuation summary (NPV_{12.5})

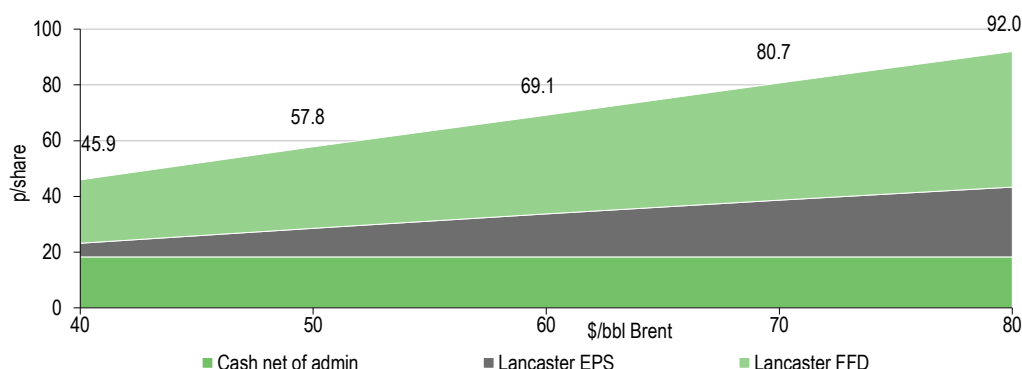
Asset	Country	Diluted WI	CCoS	Recoverable reserves/resources		NPV/boe	Net risked	Value per share
				Gross	Net		value	risked
Number of shares: 2,398m*		%	%	mmboe	mmboe	\$/boe*	\$m	p/share
Net (debt)/cash end FY17 ex convert (assumed conversion)		100%	100%				586	19
SG&A (2 years)		100%	100%				(15)	(1)
Lancaster EPS - 10y	UK	100%	90%	62	62	11.4	635	20
Core NAV							1,205	39
Contingent								
Lancaster FFD (post-EPS)	UK	49%	73%	462	226	7.9	1,310	42
Contingent RENAV				462	226		1,310	42
Lincoln		49%	48.8%	250	123	6.1	365	12
Halifax		49%	45.0%	250	123	6.1	337	11
Total inc exploration RENAV				962	471		3,218	103

Source: Edison Investment Research. Note: NPV/boe assumes a farm-out will be full capex carry for Hurricane. FX \$1.3/£. *Assuming convertible as equity.

At this stage, we do not include value from other discoveries and prospects, as there is no clarity on when appraisal/exploration wells will be drilled and/or funded. Assuming the market is not including value for assets beyond Lancaster, we believe the share price embeds an oil price below c \$40/bbl long-term Brent; however, we believe a Lancaster FFD development farm-out would be more challenging and onerous for Hurricane shareholders than we forecast if conducted based on project economics below \$50/bbl.

See further detail on EPS development project economics in our note [Big fields get bigger - 523mmbbls and counting](#) published on 16 May 2017.

Exhibit 3: Edison RENA V sensitivity to oil price*



Source: Edison Investment Research. Note: *Assumes farm-out economics at \$70/bbl long term for all cases.

Risks and sensitivities

Hurricane is subject to several sector-specific and company-specific risks. We highlight the key risks below.

Sector risks

Generic sector risks include:

- commodity price volatility;
- geological risk and uncertainty and reservoir performance uncertainty;
- recent studies on project execution in the upstream oil and gas sector suggest that up to 60% of projects incur delays and capex overruns versus FID expectations;
- small/mid-cap availability of funding: while we include the potential dilutive impact of equity funding and farm-outs in our valuation, if the cost of capital implied by equity financing or farm-outs is higher than our estimates, this would lead to additional equity NAV/share dilution; and
- volatility in service sector availability and pricing.

Company-specific risks

- Asset concentration: the bulk of Hurricane's value is based on one large asset. If this asset were to be impaired for any reason, it would have a material impact on Hurricane's share price.
- Geographical concentration: Hurricane is 100% exposed to the UKCS and petroleum fiscal terms, which have been volatile over the last decade. While tax terms and capital allowances are currently favourable versus other mature basins, there is no certainty that these will not change if oil prices were to rise significantly from current levels, potentially reducing equity holder leverage to a rising oil price.

- Funding risks: Hurricane is reliant on being able to attract additional capital to progress the Lancaster EPS and FFD and as such valuation will be sensitive to the financing availability and terms.

Financials

Financial forecasts for Hurricane incorporate Lancaster EPS first oil in 2020.

Earnings and cash flow

Earnings are limited prior to Lancaster EPS first oil; however, we expect to see a material step-up in both earnings and operating cash flow beyond this date. Free cash flow will depend on Hurricane's funding structure for FFD – we currently assume Hurricane farms down its 100% equity in Lancaster to a partner (assuming farminee 20% IRR) and is cost carried through to FFD first oil.

Balance sheet

The forecast evolution of Hurricane's balance sheet includes equity and debt funding for the EPS phase of Lancaster development as announced on 30 June 2017. Capex beyond Lancaster EPS is minimal as we assume Hurricane is fully carried post farm-down for full-field development (in exchange for reduced working interest). We expect Hurricane to select a capital structure that management believes will maximise shareholder returns.

Exhibit 4: Financial summary

	£000s	2015	2016	2017e	2018e	2019e
Year end December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		0	0	0	0	0
Operating Expenses		(5,366)	(6,500)	(7,230)	(7,230)	(7,230)
EBITDA		(5,366)	(6,500)	(7,230)	(7,230)	(7,230)
Operating Profit (before amort. and except.)		(5,448)	(6,540)	(7,325)	(7,325)	(7,325)
Exploration expenses		0	0	0	0	0
Exceptionals		0	0	0	0	0
Other		0	0	0	0	0
Operating Profit		(5,448)	(6,540)	(7,325)	(7,325)	(7,325)
Net Interest		(75)	1,839	1,598	(10,808)	(11,238)
Profit Before Tax (norm)		(5,523)	(4,701)	(5,727)	(18,133)	(18,563)
Profit Before Tax (FRS 3)		(5,523)	(4,701)	(5,727)	(18,133)	(18,563)
Tax		0	5,365	0	0	0
Profit After Tax (norm)		(5,523)	664	(5,727)	(18,133)	(18,563)
Profit After Tax (FRS 3)		(5,523)	664	(5,727)	(18,133)	(18,563)
Average Number of Shares Outstanding (m)		632.2	889.5	1,568.5	1,959.2	1,959.2
EPS - normalised (p)		(0.9)	0.1	(0.4)	(0.9)	(1.0)
EPS - normalised and fully diluted (p)		(0.9)	0.1	(0.4)	(0.9)	(1.0)
EPS - (IFRS) (p)		(0.9)	0.1	(0.4)	(0.9)	(1.0)
BALANCE SHEET						
Fixed Assets		176,231	247,621	319,661	459,731	646,890
Intangible Assets		176,012	245,146	245,146	245,146	245,146
Tangible Assets		89	15	72,055	212,125	399,284
Investments		130	2,460	2,460	2,460	2,460
Current Assets		10,771	86,152	414,977	256,774	51,052
Stocks		410	359	359	359	359
Debtors		420	5,893	5,893	5,893	5,893
Cash		9,941	79,900	408,725	250,522	44,800
Other		0	0	0	0	0
Current Liabilities		(271)	(21,341)	(21,341)	(21,341)	(21,341)
Creditors		(271)	(21,341)	(21,341)	(21,341)	(21,341)
Short term borrowings		0	0	0	0	0
Long Term Liabilities		(3,221)	(4,829)	(180,648)	(180,648)	(180,648)
Long term borrowings		0	0	(175,819)	(175,819)	(175,819)
Other long term liabilities		(3,221)	(4,829)	(4,829)	(4,829)	(4,829)
Net Assets		183,510	307,603	532,649	514,516	495,953
CASH FLOW						
Operating Cash Flow		(2,558)	(4,115)	(5,632)	(18,038)	(18,468)
Net Interest		0	0	0	0	0
Tax		0	0	0	0	0
Capex		(3,407)	(46,773)	(72,135)	(140,165)	(187,254)
Acquisitions/disposals		0	0	0	0	0
Financing		22	121,338	230,772	0	0
Dividends		0	0	0	0	0
Net Cash Flow		(5,943)	70,450	153,006	(158,203)	(205,722)
Opening net debt/(cash)		(15,856)	(9,941)	(82,230)	(235,236)	(77,033)
HP finance leases initiated		0	0	0	0	0
Other		28	1,839	0	0	0
Closing net debt/(cash)		(9,941)	(82,230)	(235,236)	(77,033)	128,689

Source: Company accounts, Edison Investment Research

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