Xcite Energy

Critical year ahead

Business update

Oil & gas

2015 is a critical year for Xcite and its shareholders. Having seen its Bentley development delayed, the company is taking an innovative approach, engaging early with major service contractors to put in place a development group that would get it through FID as well as reduce execution risk to both cost and schedule. With the consortium complete, we examine how potential terms could affect returns, concluding there is strong upside potential for all parties, Xcite and contractors alike, with an aligned development strategy. However, we caution that investors need to be patient, as a sequential process of technical and commercial outcomes must be finalised before financing (and FDP) can be concluded.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	Debt (£m)	Net cash/ (debt) (£m)	Capex (£m)
12/12	13.3	(1.6)	(1.6)	(40.3)	(14.7)	(127.6)
12/13	0.0	(2.4)	(1.4)	(47.1)	(25.1)	(17.7)
12/14e	0.0	(2.3)	(4.6)	(74.3)	(39.0)	(20.6)
12/15e	0.0	(2.9)	(11.8)	(76.6)	(54.2)	0.0

Note: *PBT is normalised, excluding intangible amortisation, exceptional items and share-based payments.

Innovative contracting strategy

The signing of an MOU with COSL for drilling services completes a contractor group that will both finalise FEED and, in principle, participate in early-stage funding, allowing Xcite to finance the remainder of its c $750m initial capex to first oil without recourse to further expensive equity. The recent drop in the oil price may actually help this process as service providers see traditional margins squeezed, although Xcite must be careful to keep costs aligned with the macro environment. Above all, getting firm alignment on scope is the main objective as Xcite seeks a robust development plan that will mitigate cost and schedule exposure.

Sequential process will affect FDP timing

All the pieces are now in place to finalise the development plan that will in turn form the basis for commercial agreements with each of the contractors. However, this is a sequential process and corporate financing to complete the FDP will only be possible once all other technical and commercial pieces are in place. While the company will not commit on timing, we feel this makes FDP approval more likely to be achieved in H215, and hence first oil will be in H218 at the earliest.

Valuation: Strong upside with partner alignment

Our previous valuation models focused on farm-out scenarios as the likely route to funding. Switching this to a partnership model, we feel there is substantial scope to incentivise the contractor group with attractive returns while maintaining strong upside for Xcite shareholders. Assuming a 20% IRR to contractors, a more leveraged WACC and $80/bbl long-term Brent, we estimate a development NAV of 126p, which we expect to increase to 152p upon FDP approval. Based on our models we estimate the market is only ascribing a modest 20% chance of success that Xcite will get Bentley into production; as such there remains much to play for.

19 December 2014

Price	**38p**
Market cap	**£118m**
	US$1.6/£
Net debt (£m) end September 2014	35.6
Shares in issue	309.9
Free float	96%
Code	XEL
Primary exchange	AIM
Secondary exchange	TSX-V

Share price performance

%	1m	3m	12m
Abs	(18.3)	(40.6)	(60.1)
Rel (local)	(15.8)	(37.9)	(60.1)
52-week high/low		104.5.0p	29.5p

Business description

Xcite Energy is an oil appraisal and development company focused on heavy oil resources in the UK sector of the North Sea. It has one project, the Bentley field, in which it has a 100% working interest.

Next events

Environmental statement update	Q115
Heads of terms for contractor agreements	H115
Reserves update	April 2015
Finalise RBL and FDP approval	H215

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Edison profile page

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Investment summary: Critical year ahead

Company description: Bentley partnership group now complete

Xcite is a North Sea E&P currently focused on the development of the Bentley heavy oil field. Having substantially de-risked the project through three separate appraisal campaigns, including a 70-day extended well test (EWT), the company has been seeking partners to allow it to move towards FDP approval and first oil three years later. With a life of field capex requirement of $3.5bn, initial attempts since early 2013 to farm-out an interest in the block to cover development costs have not yet been successful. This has forced a change in strategy to one of building a core development group with key contractors that Xcite will look to provide technical expertise and to share some of the financial risk of the project. The announcement that COSL will provide drilling services completes the development group and the next steps are to complete technical and commercial agreements before financing can be finalised and the FDP approved. Subject to FDP approval in H215 we look for first oil from Bentley in H218.

Valuation: Crystal ball gazing until financing agreed

Our valuation is largely driven by the cost of corporate and project finance and the returns that the contractor group will expect in order to support the funding of Bentley. This is further complicated by a falling oil price environment that Xcite must negotiate to ensure alignment between cost and revenue once Bentley is in production. While this will not necessarily be an easy process, our analysis indicates strong returns are possible both to Xcite and the contractor group, hence the model makes sense. Our base case valuation of 126p/share is based on conservative finance assumptions that we expect to increase to 152p in the event of FDP approval, potentially in H215.

Financials: Funding linked with valuation upside

Having completed the contractor group, next steps to financing will be sequential. This will mean completing technical and commercial agreements with the key contractors (including any specific project finance arrangements) and only then finalising corporate level debt, most probably in the form of RBL or a development bond. Financing to date has been expensive, previously through equity and currently through debt that is yielding 15% pa after an initial 10% discount. However, one would expect any development bond to be priced more in line with the market given the contractor support in place and a defined balance of funding identified.

Sensitivities: Need to complete the deal

We would highlight the following sensitivities as being particularly relevant to potential investors:

- **Heavy oil development**: Previous notes have highlighted the challenges developing Bentley given the viscosity of its crude. However, the company's work to date has demonstrated the quality of reservoir and the mobility of oil both in the reservoir and through subsea flow-lines.
- **Financing**: Xcite's 100% interest in Bentley gives it significant running room to negotiate with partners; however, it also means that the company has exposure to c $3.5bn life of field development costs. This has undoubtedly delayed progress since the EWT in 2012, although our models indicate significant upside to the current share price, even if there is further slippage from the planned schedule of final investment decision (FID) in 2015 and first oil in 2018.
- **Commodity prices**: With significant capex/opex and a 12% crude discount to Brent, Xcite's margins will be more sensitive to oil price variations than most in the North Sea. However, we estimate that the project will still more than cover the current share price at Brent as low as $50/bbl, while higher price assumptions would yield considerable upside to our current NAV.

Bentley partnership group now complete

With the recent signing of an MOU with COSL (a subsidiary of CNOOC) for drilling services, Xcite has effectively completed the assembly of its core contractor development group to develop the 257mmboe 2P Bentley field in the Northern North Sea. The drilling partnership includes the provision of a new Keppel FELS N Plus Class harsh environment jack-up drilling rig, due for delivery in 2018.

The deal with COSL complements previous MOUs with AMEC, Aibel and Arup for design and development of Arup's ACE self-installing platform, and Teekay for supply of a bridge-linked Sevan FSO facility. The three agreements together will form the heart of the development and operating equipment at Bentley as shown in Exhibit 1. A separate MOU announced in October 2014 with Baker Hughes for oil field services, including the supply of drilling and completion services, well engineering, electronic submersible pumps and reservoir engineering, completes the core partnership group.

Exhibit 1: Drilling rig, platform and FSO schematic

Source: Xcite Energy

Xcite's strategy to assemble a core group of contractors ahead of Field Development Plan (FDP) completion and Final Investment Decision (FID) is both innovative and somewhat borne out of necessity. The most obvious reason is to cover an element of upfront cash costs, alleviating the need for Xcite to secure a farm-in partner ahead of FID.

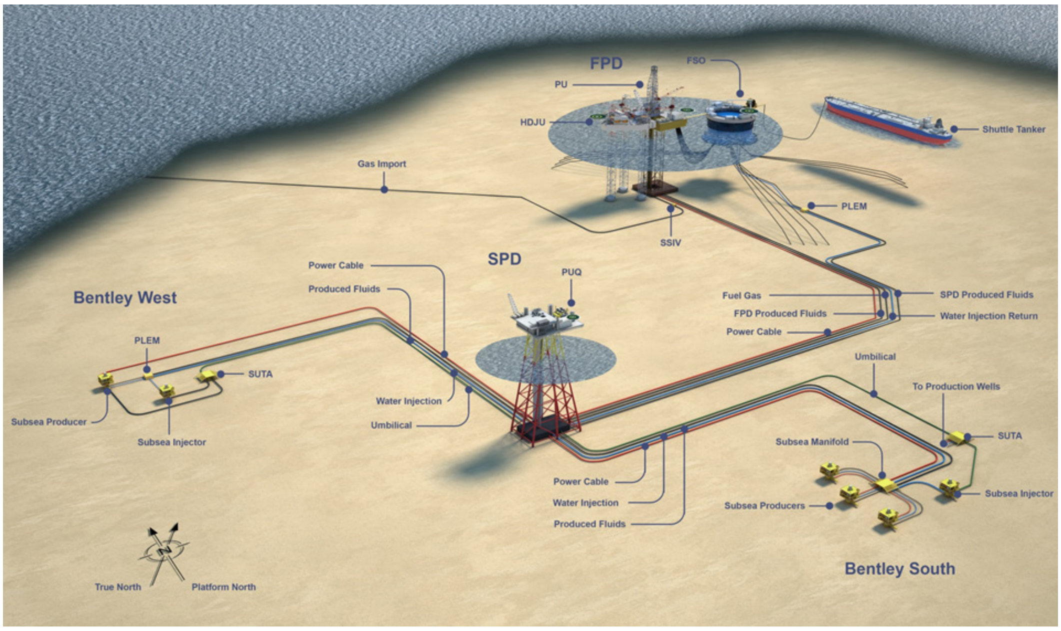
However, the approach has an equally important benefit for Xcite, given its limited financing capacity, of attempting to reduce uncertainties over cost and schedule that are often associated with major offshore development projects. We highlight that, especially with the wealth of data (and confidence) generated with the 2012 9/03b-7 EWT, effectively a mini-production facility in its own right, this has given both Xcite and by inference its chosen partners an abnormally high degree of confidence in the proposed Bentley development scheme ahead of FID. In the absence of securing a farm-out, we fully expect Xcite to still require additional (non-equity) funding of its own to get to first oil (over and above funding from the partnering group that is still under discussion); hence having the confidence that cost and schedule tolerances are better than average ahead of FID (and hence FDP approval) is particularly important to Xcite.

Simpler development plan

The development scheme is still to be finalised; however, Xcite has been keeping the market updated as to some key improvements and modifications to the development plan that should help make financing of Bentley simpler than was previously envisaged.

- **FSO vs FPSO**: Prior to the 9/03b-7 EWT it was thought that Xcite would require substantial crude processing facilities either on the platform or on a dedicated FPSO to dehydrate the oil before offloading. However, Xcite has learned that the Bentley crude naturally dehydrated in-situ in the shuttle offtake tanker over a period of 10-12 days during the EWT. Xcite therefore has had the opportunity to simplify its development scheme and use only an FSO for storage and offloading, locating the simpler processing facilities on the platform that will be bridge-linked to the Sevan FSO. This obviously saves costs by using an FSO and adds flexibility to the design options between the FSO, platform and drilling operations. By using a cylindrical Sevan style FSO (rather than a retrofitted tanker design), this should also help natural dehydration as the Sevan style will be less prone to "bobbing" in rough seas.

Exhibit 2: Bentley development schematic



Source: Xcite Energy

- **MOPU design**: Xcite is proposing to use a self-installing platform for its mobile offshore production unit (MOPU) that is easy to install and, possibly more importantly, remove at the end of the field life. Xcite expects that drilling activities across the platform could start reasonably quickly after the platform and drilling rig are jacked into place, while the installation does not require any heavy lift or installation vessels to complete which removes a major schedule variable from the installation process. Decommissioning liabilities should also be reduced as the entire platform structure can be floated away at the end of field life rather than abandoned (at significant expense) as would be the case with a fixed platform jacket on piles. Finally, having simplified the FSO design, Xcite is now proposing to locate the accommodation facilities for Bentley on the FSO rather than the platform. This reduces the weight (and cost) of the platform and will leave space on the platform for potential expansion, including the possibility of adding a modular drilling unit at a later date.
- **Drilling capability**: Xcite intends to develop Phase I of Bentley (first phase development or FPD) where circa two-thirds of the reserves are located using the COSL heavy-duty jack-up rig. However, in later years there will be a requirement for infill drilling in addition to developing

Phase II of the field (second phase development or SPD), starting approximately five years after first oil production from the FPD. By relocating the accommodation unit to the FSO, this will provide sufficient space on the platform to potentially retrofit a dedicated drilling unit at some point for follow-up drilling.

- **Subsea wells and flowlines**: Previous proposed development schemes for Bentley have included two separate platforms to develop reserves and resources in the north and south of the field using dry well-head trees. However, the EWT demonstrated both the feasibility of longer laterals and good mobility of the viscous Bentley crude through the 1.7km offtake flowline between the drilling rig and the offtake shuttle tanker. Xcite is therefore now favouring a simplified full field development scenario where all of Phase I is developed using extended laterals connected to the ACE platform, with Bentley West and Bentley South now bring produced during Phase II through subsea templates tied back to a separate SPD platform. This again will reduce the cost and complexity of the entire development.

The completed layout for both Phase I and Phase II of the development is shown in the schematic in Exhibit 2.

Timing: Progress to FDP needs to be sequential

Since launching its contracting strategy in late 2013, Xcite's focus over 2014 has been to complete the technical and commercial negotiations with its partners ahead of finalising its own financing requirements and the FDP. This was always going to be an ambitious target and we expect that some of the technical and commercial work will likely continue into 2015, hence pushing out FDP approval until later in the year. Included in this will be the next immediate step of updating the July 2013 Environmental Statement to reflect changes in the development plan over the last year or so, and in particular the inclusion of the ACE platform and Sevan FSO.

We also recognise that current volatility in oil prices could further complicate commercial discussions with the development partners. This is a critical activity as Xcite must ensure that commercial contracts are struck in alignment with commodity prices; in other words any company cannot afford to contract services in a high oil price environment and then find that prices fall substantially when in production. While seeking cost and price alignment will be a key activity when finalising commercial terms with its contracting partners, we consider that the partnership arrangement that Xcite has put together could actually help facilitate negotiations with contractors during these volatile times. We suggest this as attempting to share risk and reward with its partners could help incentivise the contracting group and make negotiations easier (on both sides) during a period when we expect standard service contractor margins to be squeezed as low oil prices impinge on global investment activities.

Xcite has been clear during 2014 that it can only finalise financing for Bentley once it has completed all its technical and commercial negotiations with the partnering group. As such, while the company cannot give guidance, we expect this could still be a few months away.

Financing: Contractor partner model expands options

Following finalisation of the technical and commercial agreements with the contracting group, Xcite will then (and only then) look to finalise financing. Few indications have been given as to the overall make-up of the financing as this will be a key part of the commercial negotiations with the partnering contractor group. However, we expect the funding to most likely come from three sources, as follows:

- A degree of cost carry from partnering contractors for field services and equipment supply;
- Project finance on key offshore facilities (most probably the MOPU platform); and

- Corporate debt, either bonds or reserve-based lending (RBL), to cover the outstanding balance of development costs over and above the two above. As a reminder, Xcite previously signed a $155m RBL facility agreement in June 2012, with drawdown subject to successfully completing a number of objectives during the 9/03b-7 EWT. This was based on expected 2P reserves at the time of c 116mmboe. Xcite would expect to secure a reserve-based facility well in excess of this given the subsequent increase in 1P reserves to the current 203mmbbl.

While the overall funding package remains to be defined, Xcite has made it clear it does not intend to utilise equity for any additional funding.

In addition to working towards funding Bentley development with the existing contractor group, we expect Xcite will continue discussions with potential farm-in partners. These discussions have some degree of inter-dependency, as all parties are keen to understand the final shape of the FDP and the financial consequences thereof prior to commitments being made. However, Xcite is keen to point out that it does not intend to formulate its base case strategy on a farm-out to complete the financing package for the FDP, with the principal focus being on contracting partners, project and corporate finance. This is important both from the perspective of assuring investors that the Bentley development will not be further delayed by farm-out talks, as well as in principle putting Xcite in a stronger position to negotiate any farm-out agreement in the event that the counterparty wants to take an equity interest in the Bentley licence.

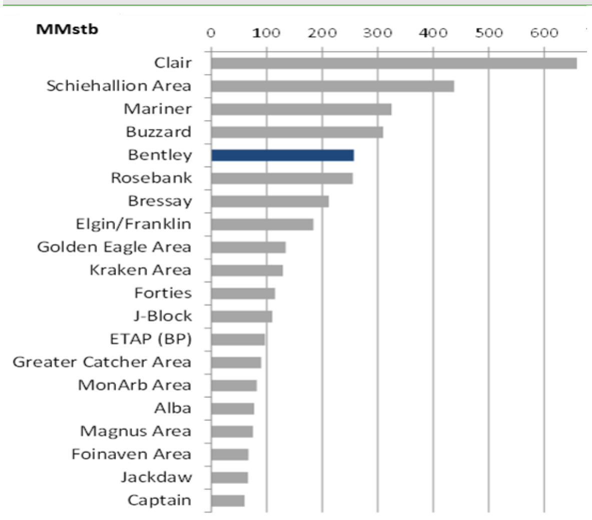
Bentley: A recap

Xcite has come a long way over the last 10 years as it looks to develop the Bentley field. For new readers to the story, it is worth recapping on the progress made to date and the key achievements that have got the company to the cusp of finalising its FDP and securing FID.

Xcite drilled three wells and two side tracks over 2008 to 2012 to prove up the heavy oil field, which was originally discovered by Amoco in 1977 and subsequently tested by Conoco with three wells over 1983 to 1986. Xcite's wells have in turn:

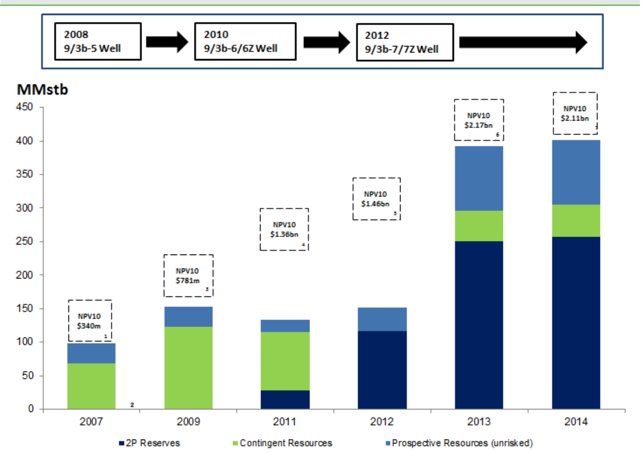
- Delivered oil to surface for the first time from a simple vertical well (the 9/03b-5 well in 2008);
- Proven a 2000ft horizontal well design and stable flow (with the 9/03b-6 and 6z sidetrack in 2010); and
- Answered all development questions with the 9/03b-7 and 7z EWT in 2012, which, among others, also met all requirements for a pre-agreed $155m RBL facility.

Exhibit 3: North Sea fields by reserves



Source: Xcite Energy, Wood Mackenzie for all other fields than Bentley. Certified 2P reserves for Bentley as at 31 Dec 2013.

Exhibit 4: Bentley reserves/resources evolution



Source: Xcite Energy

The 2012 EWT allowed Xcite's reserves auditors to increase 2P reserves from 116mmbbls to 250mmbbls in 2013 (and 257mmbbls in 2014), making it the fifth largest North Sea field by reserves (Exhibit 3 and Exhibit 4). The same reserves assessment has also valued the Bentley 1P and 2P reserves (on an NPV10 after tax basis) at c $1.5bn and $2.1bn respectively (302p and 423p per share respectively), although we caution that these are unrisked, undiluted valuations. We will explore our own valuation assumptions later in this report. The EWT also answered key questions about producing oil at commercial rates (rates of 3,500b/d were achieved from each lateral), while water was successfully managed. We note that we still do not know the full extent of how the wells and handling facilities will perform at high water-cuts, although the development plan is engineered to manage high water-cuts through the life of the production cycle.

Finally we note the progress Xcite has made working with the North Sea oil and gas industry around heavy oil developments. Xcite announced in May 2014 that it had signed a collaboration agreement with Statoil and Shell to share information on the development of Bressay and Bentley. Bressay has been delayed in recent years as Statoil and Shell hone their development plans (Chevron's Rosebank project has also been delayed) and we view the collaboration agreement as positive progress towards delivering the Bentley development plan.

Management: Experience aplenty

The majority of the core of Xcite's management team has been in place for many years, putting them in a strong position to lead the development of Bentley through to FID.

- **Rupert Cole, CEO**: Prior to joining Xcite in 2003, initially as CFO and then from 2013 as CEO, Rupert was programme management business adviser at Granherne (a Halliburton company) providing strategic, commercial and financial advice to upstream oil and gas services providers. From 1990 to 1996, he was FD at Harpur, an international downstream service provider to major oil companies. Rupert is a CA and has over 23 years of experience in corporate finance.
- **Stephen Kew, COO**: Stephen is a petroleum engineer and has over 34 years of development engineering and project management experience in the oil and gas industry, including 25 years with Conoco where he gained experience of the Bentley field, Block 9/3b. He has been a director of 3 Sigma Limited since 1999, a petroleum engineering consultancy company in the upstream oil and gas business. He is an associate of the Institution of Chemical Engineers, a member of the Society of Petroleum Engineers and a former president of the Scottish Oil Club.
- **Andrew Fairclough, CFO**: Andrew joined Xcite Energy as director of corporate affairs in August 2012 and became CFO in February 2014. He has over 17 years of investment banking experience, both in corporate broking and corporate finance, having worked at Flemings, Rothschild, Merrill Lynch and Espirito Santo Investment Bank, amongst others.

Sensitivities: Need to complete the deal

In the case of Xcite, we would focus investors on the following, recognising that in key areas the company has made good progress in recent years:

- **Heavy oil:** In previous notes we have highlighted the challenges Xcite faces to develop Bentley given the viscosity of the crude. However, the work to date, and in particular the 9/03b-7 EWT, has demonstrated both the quality of reservoir and the mobility of oil both in the reservoir and through subsea flowlines. The 2012 RBL sanction included a requirement to demonstrate oil movement control and this has been achieved successfully. We are also heartened by the collaboration agreement that Xcite has signed with Shell and Statoil to allow all parties to share field-specific technical and operational information between the Bentley and Bressay fields.

- **Financing:** Retaining its 100% working interest in Bentley has given Xcite significant running room to negotiate funding deals, initially with prospective farm-out partners, and more recently with contracting partners. However, it also means that the company has exposure to the significant c $3.5bn life of field development costs, although this will be split between the first phase and the second phase, which would be funded through cash flow. This has undoubtedly delayed progress since the 9/03b-7 EWT, although there remains significant upside to the current share price despite both past and potentially future delays to the planned schedule of FID in 2015 and first oil in 2018.
- **Commodity prices:** With significant capex and opex, and Bentley crude expected to sell at 12% below Brent, Xcite's margins will be more sensitive to oil price variations than most in the North Sea. However, with 257mmboe of 2P reserves and a phased development, we estimate that the project will still return upside to the current share price at Brent as low at $50/bbl (see later under Valuation). In saying this, we also recognise that falling prices may squeeze contractor margins, which may in turn make Xcite's negotiations with contractors easier.

Financials: Funding linked with valuation upside

As highlighted in previous notes, Xcite's new funding strategy creates some uncertainties over the equity capital investments required to develop Bentley. The various financing arrangements (contractor partner participation, higher-yield project finance and lower-yield corporate level reserve-based lending) will all have an impact on our valuation. As such, we need to consider the combination of these elements, even in the absence of a farm-out, when ultimately assessing our valuation. Part of the funding equation will be both reserve-based lending and contractor funding. While Xcite has been clear it will want to complete the technical and commercial agreements before finalising additional funding, for the purposes of valuation we look at this in reverse.

Debt capacity

A key unknown to Xcite funding Bentley will be its access to debt, both to replace $135m of existing two-year senior secured bonds (cash interest coupon of 12% along with a 3% pa payment in kind coupon) and to fund the remainder of the outstanding c $750m of funding to first oil. The company previously had secured a $155m reserve-based lending (RBL) facility agreement in June 2012, with drawdown subject to successfully completing a number of objectives during the 9/03b-7 EWT and was based on reserves of 96mmbbls 1P and 116mmbbls 2P (reserves having been announced in February 2012). Subsequent to this Xcite has issued two reserves reports with the 1P estimate now sitting at 203mmbbls and 2P at 257mmbbls (as of early 2014).

At the same time as 1P reserves have more than doubled, we have also recently seen a drop in oil price, which we expect will somewhat squeeze the debt capacity available to Xcite. To give an indication of the potential RBL capacity, we assume that banks are now likely to lend on a markedly reduced price deck, potentially as low as $50/bbl. However, even assuming this and developing the 1P reserves with a leveraged 14% discount rate (at the upper end of discount rates that we would expect banks to apply to an RBL calculation) this would still imply distress case returns of c $1.5/bbl and hence debt capacity of c $300m available to Xcite (based on 203mmbbls of 1P reserves). This also broadly fits with the movement in reserves since the previous facility was secured.

An alternative funding route to RBL would be via a development bond. Being asset-value based this is likely to require more market comparative returns with the contractor support in place.

Contractor/project finance to complement corporate debt

Beyond RBL or a development bond, we expect the remainder of the capex to first oil (ie c $450m) will come from a combination of cost carry from partnering contractors for field services and equipment supply, and project finance on key offshore facilities, most probably the MOPU platform.

We do not have any insight into commercial negotiations that are ongoing between Xcite and its contractor partners; however, we think it reasonable to assume that the contractors will want a rate of return on any upfront capital that will satisfy their own internal investment hurdles. For the purposes of our modelling we have used the metric for the Bowleven and Petrofac development deal on Etinde, offshore Cameroon, wherein Petrofac expected a 20% IRR on its investment. While this deal may not be directly comparable, it does provide a benchmark for our purposes. We also note that with falling oil prices (and an expected squeeze on contractor margins) Xcite may be in a position to negotiate more favourable terms than previous deals (and hence upside to our current valuation).

Valuation: Crystal ball gazing until financing agreed

Our core NAV is based on the development of Bentley, assuming a base case $80/bbl real (2% inflation pa) Brent crude price. We continue to estimate a 12% discount to Brent (at the conservative end of estimates given the successful sale of EWT crude via BP in 2012), with first oil assumed in H218, 36 months after anticipated FDP approval in 2015. Our capex assumptions are based on publically available estimates from the company's "Statement of Reserves Data and other Oil and Gas Information (Form 51-101F1)" published February 2014, although these could change with the new proposed development plan. While our previous valuations have been based on various farm-out scenarios, we now switch our approach to one of estimating the terms of a debt, project finance and contractor funding arrangement as discussed above. To reflect the unusual funding approach and potential for relatively expensive financing arrangements in the absence of a classic farm-in, we increase our discount rate to 12%.

With these assumptions built into our model, our valuation moves from 147p/share to 126p/share (Exhibit 5). This is based on a pre-FID chance of success of 55%, a slight reduction from previous assumptions reflecting the ongoing delays to finalising the contractor agreements and getting FID secured. Upon securing FID we would expect to increase our CoS to 65%, increasing our NAV to 152p. We reiterate that, pending financing, our valuation is indicative only and we will update it once details of the funding arrangements with the contractor group and various debt agreements are in place.

Exhibit 5: Xcite valuation

				Recoverable reserves			Net risked	Value per share
Asset	**Country**	**Diluted WI**	**CoS**	**Gross**	**Net**	**NPV/boe**	**value**	**risked**
		%	**%**	**mboe**	**mboe**	**$/boe**	**$m**	**p/share**
Net (debt)/cash							(62)	(13)
SG&A							(14)	(3)
Core NAV							**(77)**	**(15)**
Bentley	UK	100%	55%	257	257	5.6	703	142
Development NAV							**627**	**126**

Source: Edison Investment Research

Sensitivities

Given the oil price has fallen dramatically in recent weeks, we recognise that investors will want to understand the exposure of the Bentley economics to the prevailing oil price. As has been shown in previous notes, our analyses indeed show the economics to be highly sensitive to the oil price, as shown in Exhibit 6, although we note that the project continues to offer upside to the current share price at Brent as low as $60/bbl. While this in itself is insightful, what we do not know with this analysis is the impact that falling prices will have on service costs, both in the near and medium term. We fully expect margin squeeze across the oil service sector if oil prices remain low (ie below $90/bbl Brent) and this will in turn enhance the economics of Bentley. This is why Xcite is keen to stress the importance of contracting its service costs on a basis consistent with the prevailing oil price.

Exhibit 6: Impact of oil price and discount on development NAV (p/share)

			Discount to Brent (%)		
Oil price ($/bbl)	**6%**	**8%**	**10%**	**12%**	**14%**
50	45	41	37	33	28
65	96	91	87	82	77
80	142	137	132	**126**	121
95	186	180	174	168	162

Source: Edison Investment Research

In addition to commodity prices, FID timing and the final financing terms (and hence the company WACC) will also significantly affect our valuation. With debt in principle available, we run our models at a 12% cost of capital (recognising the significant cost of existing finance terms and uncertainty over future arrangements), but our analysis continues to show significant upside to the current share price, even assuming a 14% or 16% WACC (Exhibit 7). We expect that first oil in 2018 is an ambitious target and currently show this as an H218 event in our model, but clearly further project delays will have an impact on our valuation accordingly.

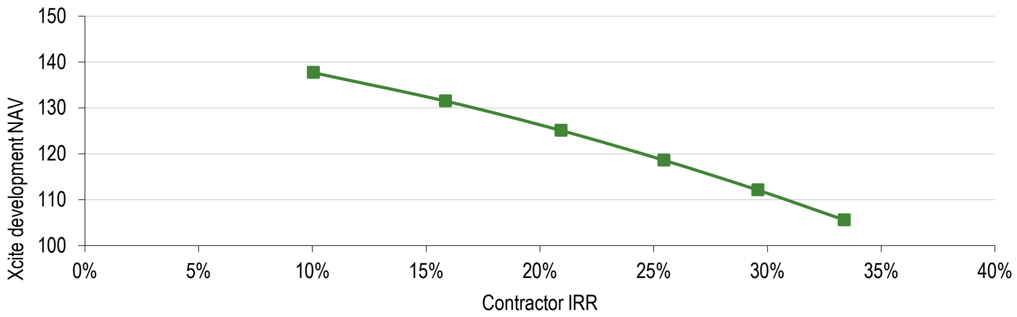
Exhibit 7: Impact of FID delay/first oil on development NAV (p/share)

		First oil			
Discount rate	**2017**	**2018**	**2019**	**2020**	**2021**
8%	214	206	197	193	191
10%	170	161	152	147	146
12%	135	**126**	118	114	112
14%	108	100	93	89	88
16%	87	80	73	70	69

Source: Edison Investment Research

Finally, we look at the impact of financing arrangements with Xcite's partner contractor group. Our base case is to assume that contractors will look for a 20% IRR against c $450m of funding to get to first oil (over and above c $300m of debt), although we can expect this to reduce if project financing is secured for the MOPU platform. Movement in the required contractor IRR has a relatively modest impact on Xcite's development NAV (Exhibit 8), hence our conclusion that Bentley economics are such that there will be sufficient upside potential for all parties, Xcite, lenders and contractors alike, if an aligned funding strategy can be agreed.

Exhibit 8: Impact of contractor returns on development NAV (p/share)



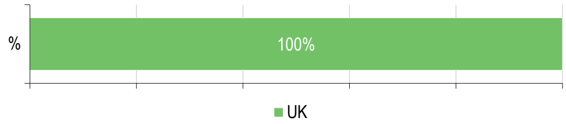
Source: Edison Investment Research

Exhibit 9: Financial summary

£'000s	2012	2013	2014e	2015e	2016e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	13,289	0	0	0	0
Cost of Sales	(13,156)	217	170	0	0
Gross Profit	133	217	170	0	0
EBITDA	(1,600)	(2,355)	(2,251)	(2,850)	(3,366)
Operating Profit (before GW and except.)	(1,733)	(2,572)	(2,451)	(2,850)	(3,366)
Intangible impairment	0	0	0	0	0
Exceptionals	(164)	(497)	(880)	0	0
Other	0	11,437	0	0	0
Operating Profit	(1,897)	8,368	(3,331)	(2,850)	(3,366)
Net Interest	176	1,165	(2,196)	(8,965)	(6,092)
Profit Before Tax (norm)	(1,557)	(1,407)	(4,647)	(11,815)	(9,457)
Profit Before Tax (FRS 3)	(1,721)	9,534	(5,527)	(11,815)	(9,457)
Tax	0	(2,952)	0	0	0
Profit After Tax (norm)	(1,557)	7,079	(4,647)	(11,815)	(9,457)
Profit After Tax (FRS 3)	(1,721)	6,582	(5,527)	(11,815)	(9,457)
Average Number of Shares Outstanding (m)	258.6	291.7	301.0	309.9	309.9
EPS - normalised (p)	(0.6)	2.4	(1.5)	(3.8)	(3.1)
EPS - FRS 3 (p)	(0.7)	2.3	(1.8)	(3.8)	(3.1)
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	N/A
BALANCE SHEET					
Fixed Assets	216,960	242,467	268,152	268,152	268,777
Intangible Assets	216,737	236,796	262,661	262,661	262,661
Tangible Assets	222	5,671	5,491	5,491	6,116
Investments	0	0	0	0	0
Current Assets	34,881	27,010	35,344	22,408	12,599
Stocks	0	0	0	0	0
Debtors	9,289	5,079	0	0	0
Cash	25,592	21,931	35,344	22,408	12,599
Other receivables	0	0	0	0	0
Current Liabilities	(46,061)	(52,483)	(5,600)	(4,206)	(3,457)
Creditors	(5,790)	(5,432)	(5,600)	(4,206)	(3,457)
Short term borrowings	(40,271)	(47,052)	0	0	0
Long Term Liabilities	0	0	(74,311)	(76,565)	(76,565)
Long term borrowings	0	0	(74,311)	(76,565)	(76,565)
Other long term liabilities	0	0	0	0	0
Net Assets	205,780	216,994	223,586	209,789	201,354
CASH FLOW					
Operating Cash Flow	(9,496)	(559)	8,483	(3,971)	(3,093)
Net Interest	176	28	(2,196)	(8,965)	(6,092)
Tax	0	0	0	0	0
Capex	(127,644)	(17,732)	(20,631)	0	(625)
Acquisitions/disposals	0	0	0	0	0
Equity financing	63,418	12,756	10,961	0	0
Dividends	0	0	0	0	0
Net Cash Flow	(73,546)	(5,508)	(3,383)	(12,936)	(9,810)
Opening net debt/(cash)	(64,123)	14,679	25,121	38,966	54,157
Other	(5,256)	(4,934)	(10,463)	0	0
Accrued interest	0	0	0	(2,255)	0
Closing net debt/(cash)	14,679	25,121	38,966	54,157	63,967

Source: Edison Investment Research, company accounts

EDISON

Contact details	Revenue by geography
XER Corporate office 1 Farnham Road Guildford GU2 4RG UK +44 0844 5930 160 www.xcite-energy.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 12-16e	N/A	ROCE 14e	N/A	Gearing 14e	N/A	Litigation/regulatory	◖
EPS 14-16e	N/A	Avg ROCE 12-16e	N/A	Interest cover 14e	N/A	Pensions	◖
EBITDA 12-16e	N/A	ROE 14e	N/A	CA/CL 14e	N/A	Currency	◖
EBITDA 14-16e	N/A	Gross margin 14e	N/A	Stock days 14e	N/A	Stock overhang	○
Sales 12-16e	N/A	Operating margin 14e	N/A	Debtor days 14e	N/A	Interest rates	●
Sales 14-16e	N/A	Gr mgn / Op mgn 14e	N/A	Creditor days 14e	N/A	Oil/commodity prices	●

Management team

CEO: Rupert Cole

Prior to joining Xcite in 2003, initially as CFO and then, from 2013 as CEO, Rupert Cole was programme management business adviser at Granherne, providing strategic, commercial and financial advice to upstream oil and gas services providers. From 1990 to 1996, he was FD at Harpur, an international downstream service provider to major oil companies. He is a chartered accountant and has over 23 years of experience in corporate finance.

COO: Stephen Kew

Stephen Kew is a petroleum engineer with over 34 years of development engineering and project management experience in the oil and gas industry, including 25 years with Conoco, where he gained experience of the Bentley field, Block 9/3b. He has been a director of 3 Sigma Limited, a petroleum engineering consultancy company in the upstream oil and gas business, since 1999. He is an associate of the Institution of Chemical Engineers, a member of the Society of Petroleum Engineers and a former president of the Scottish Oil Club.

CFO: Andrew Fairclough

Andrew Fairclough joined Xcite Energy as director of corporate affairs in August 2012 and became CFO in February 2014. He has over 17 years of investment banking experience, both in corporate broking and corporate finance, having worked at Flemings, Rothschild, Merrill Lynch and Espirito Santo Investment Bank, amongst others.

Principal shareholders	(%)
Socius CG II Ltd	6.05%
Rupert Cole	2.26%
Stephen Kew	2.01%

Companies named in this report

Shell, Statoil, BP

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Germany	United Kingdom	US	NSW 2000, Australia	New Zealand