Rockhopper Exploration

Phase 1, a step closer to FID

Sea Lion progress

Oil & gas

Premier Oil's (PMO) half-year results included several indications of the operator's intent to progress the development of Sea Lion. This included: 1) sanction by Premier's board of the Tolmount gas project, a key project that precedes Sea Lion in Premier's development hopper (Falkland's accounted for c 44% of Premier's December 2017 net 2P reserves); 2) PMO's expectation of remaining FCF positive at $65/bbl including Sea Lion capex; 3) the appointment of a pathfinder bank to assist with the senior financing structure of Sea Lion; and 4) signature of letters of intent (LOIs) with selected contractors for the provision of services and vendor financing. LOIs have been signed with the Sea Lion FPSO provider, drilling contractor, subsea equipment provider, well services, subsea installation contractor and for helicopter services. While Premier did not provide guidance on the timing of final investment decision (FID) for Sea Lion, we assume the project will be sanctioned in mid-2019 with the potential for first oil four years later in 2023. Our latest Rockhopper RENAV of 73.6p/share assumes a 55% commercial chance of success for Sea Lion Phase 1 based on a long-term Brent crude price of $70/bbl.

Year end	Revenue ($m)	PBT ($m)	Cash from operations ($m)	Net (debt)/ cash ($m)	Capex ($m)
12/16	7.4	98.0	(21.2)	81.0	(40.2)
12/17	10.4	(9.0)	1.6	50.7	(26.8)
12/18e	10.7	(11.6)	2.6	35.0	(18.5)
12/19e	8.9	(18.1)	0.1	33.0	(2.2)

Note: Figures as reported

Funding next step for Sea Lion

Key next steps in the advancement of Sea Lion include the finalisation of the pathfinder bank's due diligence work for the project's senior lending syndicate. Pathfinder due diligence work is likely to include inputs from numerous independent sources including the project reserves auditor and environmental consultant. The development of Sea Lion Phase 1 remains contingent on securing senior debt and vendor funding, Premier Oil/Rockhopper internal project sanction processes and Falkland Islands Government (FIG) approval. Based on progress made to date, we believe there is a greater likelihood that the project will proceed than not, hence we increase our commercial chance of success from 40% to 55%. Uncertainty remains around the timing of project FID and hence first oil. In its results commentary, Premier mentioned that lender due diligence processes could take three to six months.

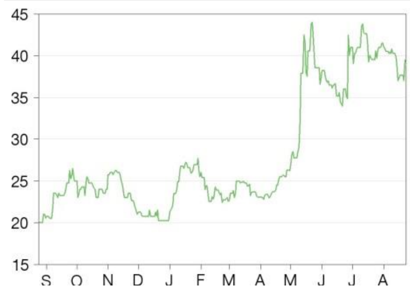
Valuation: Sea Lion funding and FID remain key

Based on an assumed 55% commercial chance of success for Sea Lion Phase 1, our RENAV stands at 73.6p/share, up from our last published 62.9p/share. We continue to base our asset valuations on a long-term oil price of Brent at $70/bbl (2022) and mark to market for recent movement in $/£ FX rates. Rockhopper reported an end-December 2017 unaudited $51m in cash and no debt, providing visibility of funding of overheads. We expect this to fall to c $35m by year-end FY18.

24 August 2018

Price	**39.0p**
Market cap	**£178m**
	US$/£0.73
Net cash ($m) at 31 December 2017	50.7
Shares in issue	457.4m
Free float	93%
Code	RKH
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(0.9)	(8.5)	97.5
Rel (local)	1.2	(5.9)	92.0
52-week high/low		44p	20p

Business description

Rockhopper is a London-listed E&P with fully funded development of Sea Lion, a 500mmbbl+ field in the Falklands as well as the potential for a similar size discovery to the south. It also holds production and exploration assets in the Mediterranean.

Next events

Sea Lion FID	H119
Funding closing	H119
Ombrina Mare arbitration	Mid-2019

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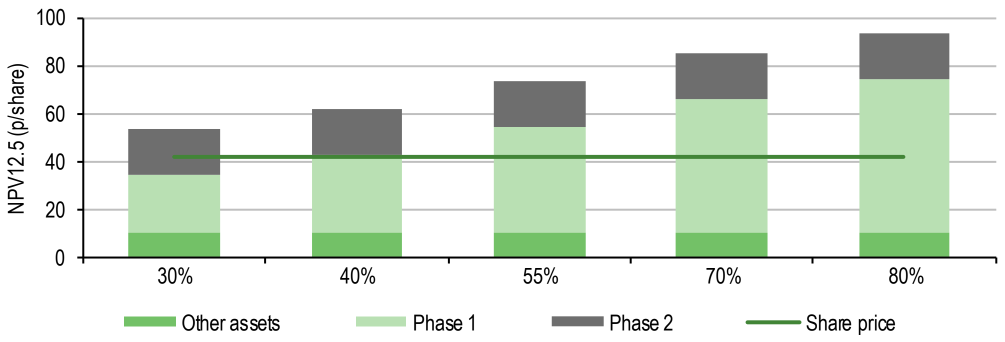
Edison profile page

Rockhopper Exploration is a research client of Edison Investment Research Limited

Valuation: Phase 1, a step closer to FID

The commercial chance of success for Sea Lion Phase 1 used in our valuation is subjective and a key driver of our risked group valuation. Given progress made to date, operator optimism and with Brent crude trading above $70/bbl, we believe there is more chance of the project progressing than not, hence we increase our chance of success from to 55%. Subsurface risks are low for Sea Lion Phase 1 based on extensive historic appraisal of the resource base. We provide a sensitivity to this risk factor in Exhibit 1 below. The market appears to be using either a lower chance of success or lower oil price assumption (or combination of the two) than our base case.

Exhibit 1: Sea Lion Phase 1 de-risking



Source: Edison Investment Research

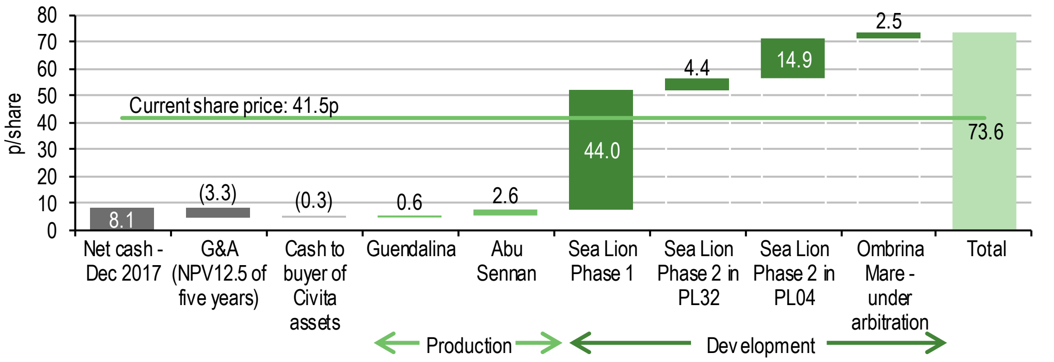
A full breakdown of our risked asset valuation is provided below, with sensitivity to the weighted average cost of capital used in our asset NPVs. Based on a 12.5% WACC, our risked valuation stands at 73.6p/share. This is an increase from our last published valuation of 62.9p/share, and is predominantly driven by a higher chance of success for Sea Lion Phase 1. Minor changes include FX rates and the impact of slightly higher oil prices for FY18 and FY19 that influence the valuation of producing assets in Egypt and Italy, which make up 4% of our group valuation.

Exhibit 2: Rockhopper risked valuation

Shares: 457m					Recoverable reserves		Net risked value					
			WI	CoS	Gross	Net	NPV 12.5%			Sensitivity to WACCs		
Asset	**Country**	**First oil**	**(%)**	**(%)**	**(mmboe)**	**(mmboe)**	**($/boe)**	**($m)**	**p/share**	**10%**	**15%**	**20%**
Net (debt)/cash - Dec 2017								51	8.1	8.1	8.1	8.1
G&A (NPV$_{12.5}$ of five years)								(21)	(3.3)	(3.3)	(3.3)	(3.3)
Cash to buyer of Civita assets								(2)	(0.3)	(0.3)	(0.3)	(0.3)
Production												
Guendalina	Italy		20%	100%	1.2	0.2	16.6	4	0.6	0.6	0.6	0.6
Abu Sennan	Egypt		22%	100%	10	2.2	7.5	17	2.6	2.9	2.4	2.0
Development												
Sea Lion Phase 1	Falkland Islands	2023	40%	55%	221	88	5.7	277	44.0	57.9	33.3	19.0
Sea Lion Phase 2 in PL32	Falkland Islands	2028	40%	20%	87	35	4.0	28	4.4	6.7	2.9	1.2
Sea Lion Phase 2 in PL04	Falkland Islands	2028	64%	20%	214	137	3.4	93	14.9	23.8	9.1	3.0
Ombrina Mare - under arbitration	Italy							16	2.5	2.5	2.5	2.5
Core NAV					**533**	**262**		**462**	**73.6**	**99.0**	**55.4**	**32.8**

Source: Edison Investment Research. Note: FX = US$/£0.73.

Exhibit 3: Rockhopper base case valuation waterfall



Source: Edison Investment Research

Rockhopper reported end FY17 cash of $51m and no debt. We expect this to fall to c $35m by year-end FY18 (assuming a c $5m receivable unwind) as the company funds pre-sanction activity for Sea Lion, including corporate G&A as well as $3m for Abu Sennan and the Raya-1X well in Egypt.

Current cash is clearly not enough to fund the development of Sea Lion, but existing farm-out agreements with PMO will enable RKH to progress to Sea Lion first oil, based on the partner group's estimated $1.5bn gross capex bill. Existing agreements call for a $337m development carry on Phase 1, with a similar-sized carry on further phases. Given the debt-biased financing structure outlined by PMO, the carry net to Rockhopper of the $375m equity finance for Phase 1 pre-first oil would only be $150m. We would therefore not be surprised to see an evolution of the existing farm-out agreement.

Risks and sensitivities

The economics of Sea Lion remain sensitive to our underlying oil price assumption and cost of capital, as shown in Exhibit 4. A $5/bbl reduction in our long-term oil price assumption (from $70/bbl Brent to $65/bbl) has a 17% negative impact on our Rockhopper RENAV. PMO estimates that the company's net economics are break-even at c $45/bbl.

Exhibit 4: Rockhopper valuation sensitivity to long-term oil price and WACC*

WACC	7.5%	10.0%	12.5%	15.0%	17.5%
Oil price $/bbl					
50	50	35	24	17	12
60	93	68	49	37	27
70	135	99	74	55	42
80	178	131	99	75	58
90	219	163	123	94	73

Source: Edison Investment Research. Note: *Base case long-term $70/bbl Brent in 2022 and 12.5% WACC.

Funding risk: key risks are around Sea Lion's partner group's ability to secure vendor, senior debt and equity financing for the Phase 1 development.

Oil price risk: the bulk of Rockhopper's value is dependent on long-term prices, although near-term cash flows are reliant on near-term realisations in Italy and Egypt.

Fiscal regime change: the FIG is unlikely to increase the fiscal take in the foreseeable future, especially given the current outlook for oil prices. Indeed, given the delays in getting project sanction, it is in everyone's interest to incentivise first oil as soon as possible. A renegotiation of terms is therefore possible, but we are not including it in our assumptions.

Reservoir risk: Sea Lion has been extensively appraised, so reservoir distribution here is understood and the waxy nature of the Sea Lion crude known. Similar appraisal and analysis will be required at the Isobel-Elaine complex.

Argentina: relations between Argentina and the UK have thawed in recent years. In September 2016, the UK and Argentinian governments agreed to work together to remove “restrictive measures around the oil and gas industry, shipping and fishing affecting the Falkland Islands”. A second commercial flight to the Falklands is expected later this year, which requires UK and Argentinian support. We hope that a path to normalising diplomatic relations continues.

Payment and repatriation risk from Egypt: Egyptian production can be paid in a combination of Egyptian pounds and US dollars, and we believe that it is materially easier to be paid in Egyptian pounds (although to date Rockhopper has only accepted US dollars, paid directly into its UK bank accounts).

Exhibit 5: Financial summary

Accounts: IFRS, Year-end: December, US$000s	2014	2015	2016	2017	2018e	2019e	2020e
INCOME STATEMENT							
Total revenues	1,910	3,966	7,417	10,401	10,683	8,894	7,703
Cost of sales	(3,970)	(11,049)	(7,667)	(9,573)	(8,871)	(10,317)	(11,843)
Gross profit	(2,060)	(7,083)	(250)	828	1,812	(1,423)	(4,140)
SG&A (expenses)	(10,033)	(10,895)	(9,970)	(5,282)	(5,600)	(5,740)	(5,884)
Other income/(expense)	(1,782)	(22,934)	(8,237)	(3,422)	0	0	0
Exceptional and adjustments	5,844	(10)	116,527	(1,830)	(1,066)	(2,966)	(3,016)
Depreciation and amortisation	0	0	0	0	0	0	0
Reported EBIT	(8,031)	(40,922)	98,070	(9,706)	(4,854)	(10,129)	(13,039)
Finance income/(expense)	657	975	307	783	176	45	22
Other income/(expense)	(209)	(4,750)	(333)	(39)	(6,968)	(8,013)	(9,215)
Exceptional and adjustments	0	0	0	0	0	0	0
Reported PBT	(7,583)	(44,697)	98,044	(8,962)	(11,646)	(18,097)	(22,232)
Income tax expense (includes exceptional)	(5)	55,395	0	2,823	0	0	0
Reported net income	(7,588)	10,698	98,044	(6,139)	(11,646)	(18,097)	(22,232)
Basic average number of shares, m	289	293	446	457	457	457	457
Basic EPS ($)	(2.6)	3.7	22.0	(1.3)	(25.5)	(39.6)	(48.6)
Adjusted EBITDA	(13,875)	(32,814)	(15,163)	(2,403)	2,722	1,069	1
Adjusted EBIT	(13,875)	(40,912)	(18,457)	(7,876)	(3,788)	(7,163)	(10,023)
Adjusted PBT	(13,427)	(44,687)	(18,483)	(7,132)	(10,580)	(15,131)	(19,216)
Adjusted EPS (c)	(18.6)	120.2	(13.4)	(4.5)	(25.3)	(35.3)	(44.2)
Adjusted diluted EPS (c)	(18.6)	120.2	(13.4)	(4.5)	(25.3)	(35.3)	(44.2)
BALANCE SHEET							
Property, plant and equipment	12,146	12,637	18,025	11,585	16,210	17,860	15,030
Goodwill	0	0	0	0	0	0	0
Intangible assets	204,164	256,658	426,419	432,147	439,476	431,758	426,728
Other non-current assets	11,506	9,803	9,439	10,789	10,789	10,789	10,789
Total non-current assets	227,816	279,098	453,883	454,521	466,475	460,407	452,546
Cash and equivalents	199,726	110,434	81,019	50,729	35,036	33,021	30,000
Inventories	2,188	1,670	1,608	1,621	1,621	1,621	1,621
Trade and other receivables	4,681	6,199	17,184	16,840	16,000	16,000	16,000
Other current assets	1,384	2,192	495	4,354	4,354	4,354	4,354
Total current assets	207,979	120,495	100,306	73,544	57,011	54,996	51,975
Non-current loans and borrowings	0	0	0	0	0	0	86
Other non-current liabilities	60,960	106,893	93,174	85,245	92,213	100,226	109,440
Total non-current liabilities	60,960	106,893	93,174	85,245	92,213	100,226	109,526
Trade and other payables	19,358	30,457	34,012	12,772	12,772	12,772	12,772
Current loans and borrowings	0	0	0	0	0	0	0
Other current liabilities	100,439	9	9	9,450	9,450	9,450	9,450
Total current liabilities	119,797	30,466	34,021	22,222	22,222	22,222	22,222
Equity attributable to company	255,038	262,234	426,994	420,598	409,052	392,955	372,773
Non-controlling interest	0	0	0	0	0	0	0
CASH FLOW STATEMENT							
Profit for the year	(7,583)	(44,697)	98,044	(8,962)	(11,646)	(18,097)	(22,232)
Taxation expenses	0	0	0	0	0	0	0
Net finance expenses	(470)	3,942	16	(743)	6,792	7,968	9,192
Depreciation and amortisation	2,186	2,744	4,725	5,687	6,546	8,268	10,060
Share based payments	672	1,937	994	864	100	2,000	2,050
Other adjustments (impairments)	(4,415)	26,075	(115,546)	5,652	0	0	0
Movements in working capital	(1,627)	3,143	(9,433)	(868)	840	0	0
Interest paid / received	0	0	0	0	0	0	0
Income taxes paid	0	0	0	0	0	0	0
Cash from operations (CFO)	(11,237)	(6,856)	(21,200)	1,630	2,632	139	(929)
Capex	(11,261)	(80,919)	(40,203)	(26,817)	(18,500)	(2,200)	(2,200)
Acquisitions & disposals net	(24,037)	0	(13,527)	(6,266)	0	0	0
Other investing activities	84,720	39,791	77,755	521	176	45	22
Cash used in investing activities (CFIA)	49,422	(41,128)	24,025	(32,562)	(18,324)	(2,155)	(2,178)
Net proceeds from issue of shares	(225)	(2,733)	0	0	0	0	0
Movements in debt	0	0	0	9,518	0	0	86
Other financing activities (includes rig settlement)	439	2,219	(2)	(13)	0	0	0
Cash from financing activities (CFF)	214	(514)	(2)	(13)	0	0	86
Increase/(decrease) in cash	38,399	(48,498)	2,823	(30,945)	(15,693)	(2,015)	(3,021)
Currency translation differences and other	(1,155)	(794)	(2,238)	655	0	0	0
Cash at end of period	99,726	50,434	51,019	20,729	5,036	3,021	0
Net (debt) cash	199,726	110,434	81,019	50,729	35,036	33,021	29,914

Source: Company accounts, Edison Investment Research. Note: *Sea Lion capex covered by existing cost carry arrangements post sanction.

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