

## Corporate Highlights

### Company Update

# Hibiscus Petroleum

*Arbitrage Opportunity*



**RHB Research  
Institute Sdn Bhd**  
A member of the  
RHB Banking Group  
Company No: 233327 -M

26 July 2011

Share Price : RM0.535  
Recom : **Not Rated**

- ◆ **Arbitrage opportunity.** We believe the market mispriced the shares of Hibiscus Petroleum, Malaysia's first SPAC listing yesterday. At the close of trading on its first day of listing, the share price was at RM0.535, or 28.7% below the IPO price of RM0.75. The Hibiscus warrants closed at RM0.14. Together, the two instruments have a combined value of RM0.675, i.e. at the 90% refund value as stipulated under the Securities Commission's SPAC listing rules.
- ◆ **How should the shares be priced?** In our view, given the share has the 90% refund guarantee, it should trade at a minimum of RM0.675. If we include the after-tax interest over a 3-year period, the share should trade at RM0.73. We thus estimate a minimum arbitrage gain of RM0.14/share or an upside of 26.2%.
- ◆ **How should the warrants be priced?** The warrant (issued free to IPO subscribers) on the other hand has no such guarantee and therefore has greater risk. Nevertheless, we note that the warrant's performance yesterday was positive. Therefore, if we assume the warrants are accurately priced, add the exercise price of RM0.50/warrant, and without factoring in any premium, this implies the share should trade at RM0.64 – this is 20.8% higher than yesterday's close. We think there is a little bit more upside to the warrant price as the share should in fact trade at a minimum of RM0.675. This implies a minimum warrant price of RM0.175. Any arbitrage gain therefore depends on fair pricing for the share.
- ◆ **SPAC – A recap.** Under the SPAC listing rules, Hibiscus has to set aside 90% of the funds raised in a trust account. The funds must be returned to shareholders (excluding management and pre-IPO initial investors) with interest at the end of three years if no qualifying asset is identified and approved by at least 75% of shareholders. Therefore, based on the IPO price of RM0.75, this guarantees a minimum refund of RM0.675/share. After interest, the refund could be as high as RM0.73/share. The warrants have a 3-year tenure from issue date, but can only be exercised once the qualifying asset is identified and approved for acquisition.
- ◆ **Risks.** Industry risks: 1) Oil prices drop; 2) QA turns out to be low yield; and 3) Changes in country regulations for oil and gas ventures. Company risks: 1) SPACs have no track record; 2) IPO investors will not be able to ascertain the merits or risks of target acquisitions at the time of IPO.
- ◆ **Investment case.** We believe that Hibiscus shares may be suited to investors looking to participate in the long-term uptrend in oil prices, but understand that meaningful returns may take up to three years to materialise. The safeguards in place, and management's vested interest (20% stake), imply limited downside risk. However, once a QA is approved, and we understand this could happen quite quickly, we highlight that the refund guarantee is no longer applicable, and risks escalate at that point. In any case, at the current share price, the potential arbitrage gain (based on the guaranteed refund) of 26.2% implies a compounded interest of 8.1% p.a. over the next three years.

|                            |            |
|----------------------------|------------|
| Issued Capital (m shares)  | 418.05     |
| Market Cap (RMm)           | 221.6      |
| Daily Trading Vol (m shs)  | 13.0       |
| 52wk Price Range (RM)      | -          |
| <b>Major Shareholders:</b> | <b>(%)</b> |
| Management                 | 20.0       |
| Initial investors          | 5.3        |

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**Table 1: Valuing Future Assets**

|   |              |            |              |            |              |            |              |            |                         |
|---|--------------|------------|--------------|------------|--------------|------------|--------------|------------|-------------------------|
| No of qualifying assets                       | 2            | 2          | 2            | 2          | 2            | 2          | 2            | 2          |                         |
| 2P Reserves (mmboe)                           | 15           | 15         | 15           | 15         | 15           | 15         | 15           | 15         |                         |
| Effective reserves (mmboe)                    | 30           | 30         | 30           | 30         | 30           | 30         | 30           | 30         |                         |
| Average value per barrel in the ground (US\$) | 3            | 4          | 5            | 6          | 7            | 8          | 9            | 10         |                         |
| Total Value (US\$m)                           | 90           | 120        | 150          | 180        | 210          | 240        | 270          | 300        |                         |
| <b>Total Value (RMm)</b>                      | <b>274.5</b> | <b>366</b> | <b>457.5</b> | <b>549</b> | <b>640.5</b> | <b>732</b> | <b>823.5</b> | <b>915</b> |                         |
| <b>Value per share</b>                        |              |            |              |            |              |            |              |            |                         |
| Basic   | 0.66         | 0.88       | 1.09         | 1.31       | 1.53         | 1.75       | 1.97         | 2.19       | based on 418.05m shares |
| Fully Diluted (for warrants)                  | 0.33         | 0.44       | 0.55         | 0.66       | 0.77         | 0.88       | 0.98         | 1.09       | based on 836.1m shares  |

Source: RHBRI

**Table 2: Scenario Analysis**
**Scenario 1 – Valuing The IPO Shares And Warrants**

|  |  |  |  |              |              |              |              |                                  |
|--|--|--|--|--------------|--------------|--------------|--------------|----------------------------------|
| Cost per IPO share (RM)                                |  |  |  | 0.75         | 0.75         | 0.75         | 0.75         |                                  |
| <b>Guaranteed refund (RM) – Implied value of share</b> |  |  |  | <b>0.675</b> | <b>0.675</b> | <b>0.675</b> | <b>0.675</b> | 90% of the IPO price             |
| Less: Warrants exercise price (RM)                     |  |  |  | 0.50         | 0.50         | 0.50         | 0.50         | Effective entry cost for warrant |
| <b>Implied warrants trading price (RM)</b>             |  |  |  | <b>0.175</b> | <b>0.175</b> | <b>0.175</b> | <b>0.175</b> |                                  |

**Scenario 2 – Buy The Shares And Warrants In The Market; Convert The Warrants Post-QA**

|   |  |  |  |             |             |             |             |   |
|---|--|--|--|-------------|-------------|-------------|-------------|---|
| Cost per share (RM)                                     |  |  |  | 0.535       | 0.535       | 0.535       | 0.535       |   |
| Cost per warrant (RM)                                   |  |  |  | 0.14        | 0.14        | 0.14        | 0.14        |   |
| Cost of converting each warrant into one new share (RM) |  |  |  | 0.50        | 0.50        | 0.50        | 0.50        |   |
| Effective cost per share (RM)                           |  |  |  | 0.59        | 0.59        | 0.59        | 0.59        | After converting warrants into new shares |
| Qualifying Asset Value (US\$/barrel)                    |  |  |  | 7.00        | 8.00        | 9.00        | 10.00       |   |
| Implied fair value (see Table 1)                        |  |  |  | 0.77        | 0.88        | 0.98        | 1.09        | based on 836.1m shares                    |
| <b>Implied upside (%)</b>                               |  |  |  | <b>29.8</b> | <b>48.4</b> | <b>66.9</b> | <b>85.5</b> |   |

**Scenario 3 – Buy Shares In The Market**

|                                      |  |  |  |             |             |             |              |  |
|--------------------------------------|--|--|--|-------------|-------------|-------------|--------------|--|
| Share price (RM)                     |  |  |  | 0.535       | 0.535       | 0.535       | 0.535        |  |
| Qualifying Asset Value (US\$/barrel) |  |  |  | 7.0         | 8.0         | 9.0         | 10.0         |  |
| Implied fair value (see Table 1)     |  |  |  | 0.77        | 0.88        | 0.98        | 1.09         |  |
| <b>Implied upside (%)</b>            |  |  |  | <b>43.2</b> | <b>63.6</b> | <b>84.1</b> | <b>104.6</b> |  |

**Scenario 4 – Buy Warrants In The Market**

|   |  |  |  |             |              |              |              |  |
|---|--|--|--|-------------|--------------|--------------|--------------|--|
| Warrants price (RM)                         |  |  |  | 0.14        | 0.14         | 0.14         | 0.14         |  |
| Qualifying Asset Value (US\$/barrel)        |  |  |  | 7.00        | 8.00         | 9.00         | 10.00        |  |
| Implied fair value (see Table 1)            |  |  |  | 0.77        | 0.88         | 0.98         | 1.09         |  |
| Less: Warrants exercise price (RM)          |  |  |  | 0.50        | 0.50         | 0.50         | 0.50         |  |
| Implied warrants trading price post-QA (RM) |  |  |  | 0.27        | 0.38         | 0.48         | 0.59         |  |
| <b>Implied upside (%)</b>                   |  |  |  | <b>90.0</b> | <b>168.2</b> | <b>246.4</b> | <b>324.6</b> |  |

Source: RHBRI estimates

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Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

### Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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