15 July 2016 | Company Update

Hibiscus Petroleum Berhad

Cash flow boost from Anasuria cluster

Trading Idea
Fair value: RM0.40

INVESTMENT HIGHLIGHTS

- **Transformation into an upstream production company**
- **Crown jewel that contributes positively to bottomline**
- **Improving uptime and production rate to boost topline**
- **Lower opex per barrel estimated at USD18.30pb**
- **We value Hibiscus at RM0.40 per share based on the value of Anasuria's prospect**

OVERVIEW

On Aug 6, 2015, Hibiscus Petroleum Bhd (Hibiscus) and Ping Petroleum signed two sale and purchase agreements to acquire Shell and Esso's interests in the Anasuria Cluster in the North Sea, UK for USD105m (RM420.0m). Hibiscus' portion of USD52.5m (approximately RM210.0m) equates to 50% of the interests while Ping Petroleum holds the remainder. The deal also included infrastructure related to the cluster, which includes the Anasuria floating, production, storage and offloading (FPSO) vessel.

Whilst the acquisition of the shallow water cluster was completed on March 10, 2016, economic interest in the cluster accrued to Hibiscus began from 1 January 2015. Hence upon completion of the acquisition, Hibiscus recorded a gain of RM132.34m in its 3rd quarter 2016 results.

Transforming into a production company. Hibiscus Petroleum is evolving from an exploration company into a full-fledged production company with the acquisition of the 50% interest in the Anasuria cluster. The cluster is comprised of four producing fields, namely Cook, Teal, Teal South and Guillemot A. Note that the joint interest in the Cook field is 38.6% whereas the joint interests are at 100% in the remaining fields and FPSO. Collectively, the cluster is projected to have a production rate of 6,100 proved, developed, producing (PDP) barrels of oil equivalent (boe) per day. This means the asset, which has an estimated remaining economic life of 20 years, is cash-generating and profitable.

Crown jewel that contributes positively to bottomline. This is portrayed in Hibiscus' positive third quarter results. The Anasuria operation has contributed RM30.24m to its topline and RM6.44m to its gross profit in the said quarter. The fair value gain of RM135.34m from this asset has resulted in a net profit of RM80.51m for the company in the 3rd quarter. The gain is shown as a negative goodwill from business combination in its 3Q16 results.

RETURN STATS	
Price (14 July 2016)	RM0.18
Fair Value	RM0.40
Expected Share Price Return	+122.2%
Expected Dividend Yield	-
Expected Total Return	+122.2%

STOCK INFO	
KLCI	1,657.63
Bursa / Bloomberg	5199/HIBI MK
Board / Sector	Main/ Industrial Products
Syariah Compliant	No
Issued shares (m)	1,361.5
Par Value (RM)	0.01
Market cap. (RM'm)	245.1
Price over NA	0.39
52-wk price Range	RM0.14-RM0.88
Beta (against KLCI)	1.08
3-mth Avg Daily Vol	2.04m
3-mth Avg Daily Value	RM0.38m
Major Shareholders (%)	
Hibiscus Upstream SD	12.38
Polo Investments	6.61
Picadilly Middle East	3.92
Mercury Pacific Mari	3.66
OCBC Bank	3.14

The oil produced by the Anasuria Cluster is generally traded at a premium to Brent crude. Based on RPS Energy's reserves evaluation of 1 March 2016, the proved and probable (2P) reserves of the cluster is estimated at 40.5m stock tank bbls (MMstb) of oil and 28.4b of standard cubic ft (Bscf) of gas (45.2mmboe).

Improving uptime and production rate to boost topline. The oil production rate of the Anasuria Cluster was 6,033 bbl per day for the month of March this year. Moving forward, we expect a higher average oil production rate for the whole of calendar year 2016. The cashflow from the operation will be used to further enhance the facility and the FPSO. All the capex allocated for 2017 would be used to achieve better production uptime. Uptime is expected to improve to 85%-90% by 2018 from ~72% currently as a result of the capital expenditure on the FPSO life extension.

Lower opex of USD18.30 per barrel as at March. In 2015, the opex at Anasuria recorded USD24.70pb. As at March 2016, the Anasuria operating company was able to slash opex per barrel by 26% to approximately USD18.30pb. Besides, a weak GBP and strong USD will bode well for the operatorship. Year-to-date, GBP/USD has weakened by -11.3%. The average GBP/USD rate was 1.5285 last year, which is 7.2% stronger than the 1.4262 recorded to-date. We gather that approximately 80% of the opex at Anasuria is denominated in GBP.

Clear tax structure in the UK. Hibiscus will be taxed in two parts. Firstly, the 30% corporate income tax of its taxable income. The taxable income is a sum of revenue minus opex and capex. The second part is the supplementary tax, which has been reduced to 10% from 30% previously effective January this year. The taxable income for the supplementary tax comes from revenue net opex, net capex and net investment allowance for capex.

RISKS

Oil price and political uncertainties may pose risks. While oil price seems to have stabilised, any excess in supply due to slower global economic growth and high production from non-OPEC members could push down oil prices again. Hibiscus' profitability will be sensitive towards volatility of oil prices, which are in turn, affected by the dynamics of political, economic, market and regulatory factors. The outcome of Brexit has caused some political and economic uncertainties in the European region although any shift in policies is only expected in another two years. We note that markets have calmed down after the announcement of Britain's new Prime Minister Theresa May.

Foreign exchange risks. Note that 80% of Anasuria's opex is quoted in GBP. Following the Brexit outcome, GBP has weakened and it benefits the operator because operating cost is lower. A stronger USD will also boost Hibiscus' bottomline as its sales will be in USD. On the flipside, a stronger GBP to MYR and weaker USD to MYR will hurt its earnings.

Execution and production risks. Unexpected drilling conditions, adverse weather or equipment failure can lead to cost overruns. Production risks due to malfunction of the production system may also hit its profitability.

Incorrect estimation of reserve and resources will reduce the prospects of the Anasuria operations. There could be deviations to the assumptions of the reserve estimates as interpretation of the data can be complex and technical. This will in turn reduce the fair value of the asset. The risk is mitigated through the appointment of an independent energy consultancy firm, RPS Energy, to assess the asset.

VALUATION

Full-fledged upstream production company. Hibiscus has come a long way since its listing as Malaysia's first special purpose acquisition company (SPAC), to one of the country's few listed upstream oil and gas producers. Moving forward, we believe that the cash flow generated from the Anasuria cluster will be a game changer for the company. As such, the company's current market price offers investors sizable potential upside as a trading counter.

Market value of Anasuria cluster by RPS Energy. The latest valuation dated 30 June 2016 by independent valuer RPS Energy values the Anasuria cluster at approximately RM851m (USD208m) – translating to RM0.63 per Hibiscus share. We are however, taking a more conservative stance by assuming higher operating cost moving forward, more leisurely rise in crude oil prices and potentially heavier capital expenditure expenses along with the risks associated with its other assets globally.

Hibiscus valued at RM0.40 based on Anasuria's prospects. The valuation is based on the discounted cash flow methodology. Assuming a production life of 20 years based on Anasuria's total 2P oil and gas reserves of 45.2mmboe, Hibiscus' stake in Anasuria is worth RM0.40 per share. This is taking into consideration oil price assumption of USDD45-USD99 per barrel from 2016 to 2035. We note that oil from the cluster is trading at a premium to Brent crude. We opine that Hibiscus' purchase price per barrel of USD2.30pb for the asset is relatively attractive.

Key assumptions

No.	Parameters	Assumptions	Notes
1	Oil price assumption from 2016-2035	USD45-99 per barrel (pb)	
2	Long-term oil price assumption post-2020	USD85 +1% increment yearly	Anasuria oil trades at a premium to Brent
3	Corporate tax in the UK	30%	
4	Supplementary tax	10%	Reduced from 30% previously
5	USD/MYR assumption	RM3.85 per USD	Long term assumption
6	Discount rate	10%	

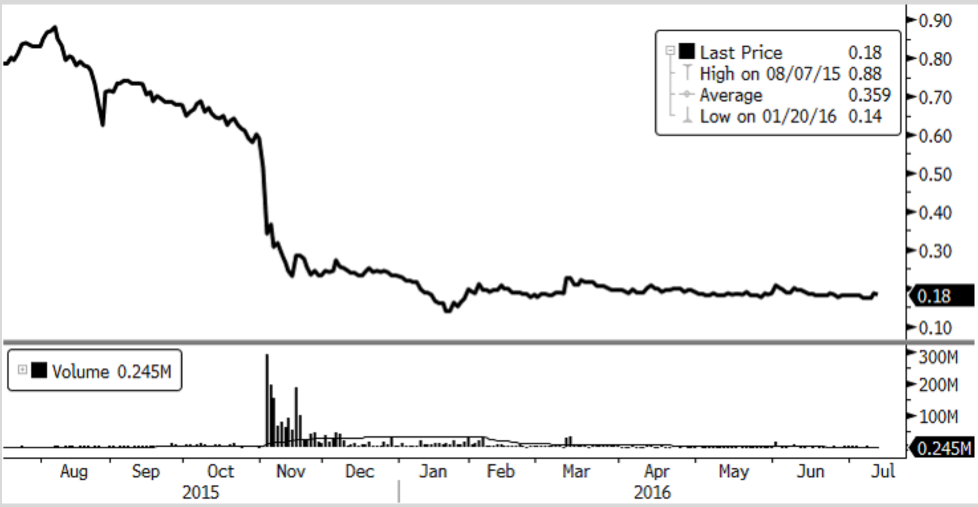
Source: MIDFR

Anasuria Operating Company Ltd's actual production post completion

	Units	Amount as of March 2016
Oil production rate	bbl/day	6,033
Gas export rate	boe/day	462
Oil equivalent production rate*	boe/day	6,495
Average oil price	USD/bbl	38.2
Average gas price	USD/mmbtu	1.6/3.5
Capital expenditure	USD 'm	-
Operating expenditure (opex) per calendar month	USD 'm	3.7
Opex per barrel	USD/boe	18.3

Source: Company

DAILY PRICE CHART



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Source: MIDFR, Company

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.