PUBLIC INVESTMENT BANK

PublicInvest Research *Non-Rated Note*

Monday, January 9, 2017

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HIBISCUS PETROLEUM

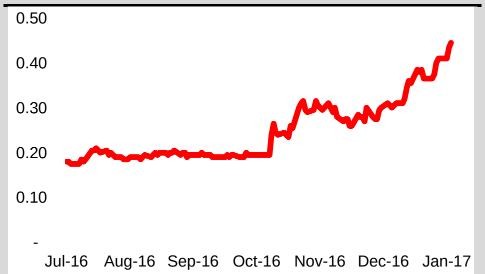
Fair Value: RM0.60

DESCRIPTION

A oil and gas production and development company, currently producing average 3,300bbls/day. Hibiscus has 26.7mbbls/day of 2P reserves (Anasuria Cluster – UK), and 6.8mbbls of 2C resources (West Seahorse Field – Australia).

Fair Value	RM0.60
Current Price	RM0.435
Expected Return	+37.1%
Market	Main
Sector	Oil & Gas
Bursa Code	5199
Bloomberg Ticker	HIBI MK
Shariah-compliant	No

SHARE PRICE CHART



52 Week Range (RM)	0.13-0.46
3-Month Average Vol ('000)	42,407.9

SHARE PRICE PERFORMANCE

	1M	**3M**	**6M**
Absolute Returns	43.5	128.2	147.2
Relative Returns	38.7	121.9	138.1

KEY STOCK DATA

Market Capitalisation (RM m)	628.1
No. of Shares (m)	1443.8

MAJOR SHAREHOLDERS

	%
Hibiscus Upstream, Sdn Bhd	11.7
Polo Investments Limited	9.6
Littleton Holdings Pte Ltd	3.7

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Realising The Value

Hibiscus Petroleum has come away from its special purpose acquisition company (SPAC) status to qualify as a O&G production and development company. We believe contributions delivered from its first producing field, the Anasuria Cluster in UK, has anchored its position more prominently amongst its oil peers. We are thus reviewing Hibiscus, premised on the undervaluation of its Anasuria Cluster asset valued at RM0.60 based on our DCF valuation with an 11.0% WACC. There is also further potential upside, with the conditional sale and purchase agreement (SPA) for the Group to acquire the 50% stake of the North Sabah Enhanced Oil Recovery (EOR) PSC, a partnership with Petronas Carigali which seems within reach, expected latest mid-2017. As a sweetener to the acquisition if successful, the deal structure will recognize contributions to the Group back-dated from 1 January 2017 onwards.

- **Upside from core operations.** We value Hibiscus' 50% stake in Anasuria Cluster at RM0.60 based on our DCF valuation with an 11.0% WACC. The Group currently owns and operates the field together with Ping Petroleum Limited. Our valuation has accounted for the decommissioning capex and various taxes.

- **Potential upside boost.** The conditional SPA with Sabah Shell Petroleum Company Limited and Shell Sabah Selatan Sdn Bhd to acquire a 50% participating interest in the 2011 North Sabah EOR PSC with Petronas Carigali for USD25m, comprising of 4 producing fields and all its associated equipment and assets including the Labuan Crude Oil Terminal is worth an estimated RM0.55. This assumes the production of its 2P remaining reserves of 62MMstb, no additional capex investment, OPEX cost of USD13.30/bbl through the remaining lifespan of the production rights (of 24years) up to 2040.

- **Higher, stable oil price** at about USD50/bbl levels enhances attractiveness. We see this holding up based on i) OPEC's agreement to cap output at 32.5mbbl/sday, ii) President-elect Donald Trump's energy independence vision to only take shape at a much later stage, iii) end of the prolonged oil price cycle which should see new operations coming online, otherwise a major depletion of 20% could be seen as soon as 2017 onwards with the supply crunch in 2019.

- Our base case **fair value of RM0.60** is premised on a DCF valuation of Hibiscus' 50% stake in the Anasuria cluster with a 11.0% WACC. We are also positive on a further upside boost of an additional RM0.55 with the potential acquisition of the North Sabah asset. The total fair value of Hibiscus would therefore be RM1.15 if the acquisition is successful, pending approvals from Petronas. The base case scenario however of RM0.60 still offers a potential 37.1% upside from current share price.

COMPANY BACKGROUND

Hibiscus was listed on Bursa Malaysia on 15 July 2011 as a Special Purpose Acquisition Company (SPAC). The Group's major milestones since then was i) completing the acquisition of the Anasuria Cluster in UK, a 50:50 joint-operating asset with Ping Petroleum which is currently producing about average 3,300bbls/day of oil and with up to 26.7mbbls of 2P (proven + probable) reserves. ii) successfully completed the drilling of an exploratory well in Sea Lion under VIC/P57 in Australia, and iii) Signed a SPA agreement with Shell Malaysia to acquire 50% of Sabah Shell Petroleum Company's interest in the 2011 North Sabah EOR PSC, thus on track in expanding its portfolio.

We met with Hibiscus Petroleum's management recently, with positive updates on its progress in evolving from an exploration-based company (up to 2014) during its qualifying acquisition stages to becoming an O&G production and development-focused company. The Group's core operations are supported by contributions from its first producing field, the Anasuria Cluster in UK acquired from Shell UK Limited, Shell EP Offshore Ventures Limited and Esso (Exxon) Exploration and Production UK Limited (vendors).

Hibiscus has subsequently been able to capitalize on its working relationship with Shell, through signing the conditional SPA for the Group to acquire its 50% stake of the North Sabah Enhanced Oil Recovery (EOR) PSC, the asset in question, a partnership with Petronas Carigali seems within reach, expected latest mid-2017. As a sweetener to the acquisition if successful, the deal structure will recognize contributions to the Group back-dated to 1 January 2017 onwards.

Currently producing average 3,300bbls/day, providing a steady production base and hence contribution to the Group.

3,300bbls/day current performance. Hibiscus has 26.7mbbls/day of 2P reserves (Anasuria Cluster – UK), and 6.8mbbls of 2C resources (West Seahorse Field – Australia). Currently producing 4,000bbls/day, this provides a steady production base and earnings contribution to the Group. We value Hibiscus' 50% stake in Anasuria Cluster at RM0.60 based on our DCF valuation with an 11.0% WACC.

Figure 1: Anasuria Cluster Asset Overview

	Achieved for 1QFY17
Oil Production Rate	3032 bbls/day
Gas Export Rate (1)	374 boe/day
Oil Equivalent Production Rate	3406 boe/day
Total Oil Sold	271576 bbls
Total Gas Exported (Sold)	206 mmscf
Average Oil Price	USD45.21/bbl
Average Gas Price	1.33/3.30 (2) mmbtu
OPEX Per Boe	USD18.39/boe
Average Uptime / Availability Of Anasuria Facilities	82%

(1) *Conversion rate of 6,000 standard cubic feet ("**scf**")/boe.*
(2) *USD1.33/mmbtu for Cook field and USD3.30/mmbtu for Guillemot A, Teal and Teal South fields.*

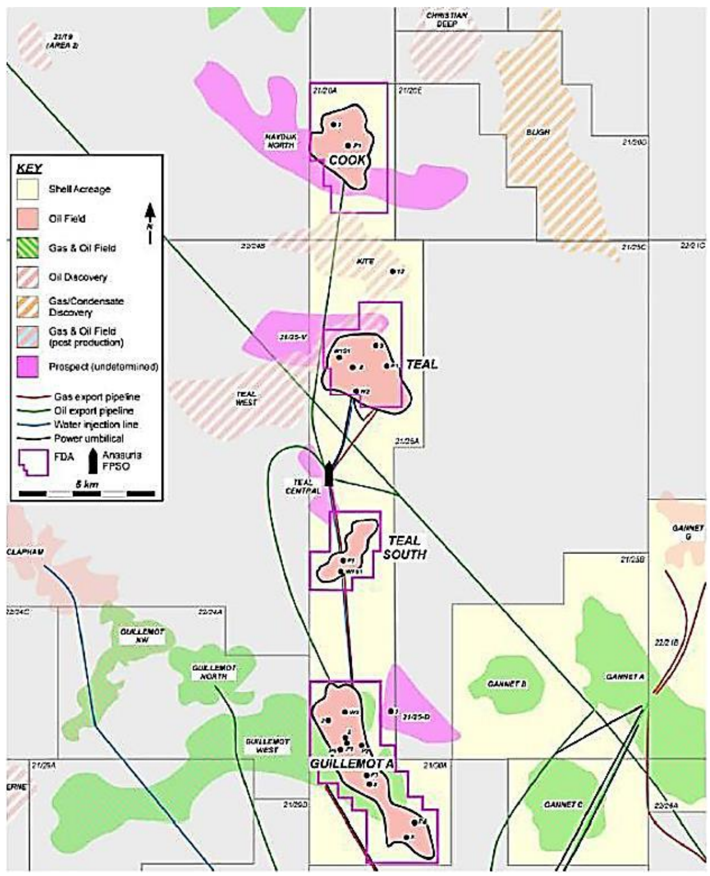
Source: Company

Figure 2: DCF Valuation On Anasuria Cluster

Cost of Debt	5.0%
Cost of Equity	12.7%
Risk Free Rate	3.8%
Market Risk Premium	9.1%
Beta	1.0
Equity	77.8%
Debt	22.2%
Terminal rate	2.0%
WACC *	**11.0%**
Total DCF	419.9
No. of Shares ('000)	1443
Fair Value (USD)	0.29
Fair Value (RM) @ 4.10	1.19
Hibiscus Portion (50% interest) RM	**0.60**

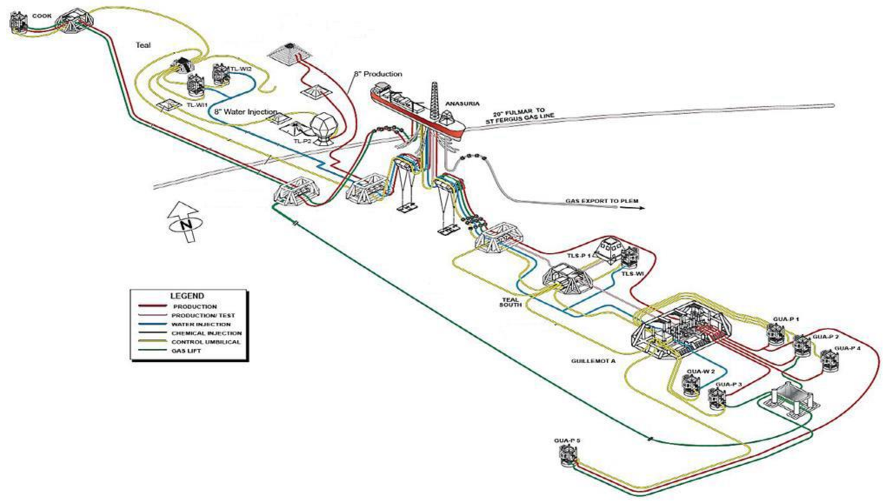
Source: Public Investment Research estimates

Figure 3: Anasuria Cluster Map



Source: Company

Figure 4: Schematic Of Field Layout and Infrastructure



Source: Company

CURRENT AND FUTURE PLANS

North Sabah PSC. On 12 October 2016, Hibiscus via its indirect wholly-owned subsidiary, SEA Hibiscus signed a conditional SPA with Sabah Shell Petroleum Company Limited and Shell Sabah Selatan Sdn Bhd to acquire a 50% participating interest in the 2011 North Sabah EOR PSC with Petronas Carigali for USD25m. From our understanding, the deal is contingent on approval from Petronas, and if approved is expected to be completed by latest mid-2017. The acquisition comprising of 4 producing fields and all its associated equipment and assets including the Labuan Crude Oil Terminal is worth an estimated RM0.55. The acquisition will entail SEA Hibiscus becoming the operator of the PSC, and includes:-

i) production of petroleum from 4 existing oil fields, namely St Joseph, South Furious, SF30 and Barton; and
ii) an existing pipeline infrastructure, the Labuan Crude Oil Terminal, and all other equipment and assets relating to the PSC.

Figure 5: North Sabah EOR PSC Asset Overview

	Total
Average Daily Production (3)	18 kstb/day
Remaining Reserves (2P) (4)	62 MMstb
Contingent Resources (2C) (4)	79 MMstb
Platforms/Structures	19
Wells	135
OPEX per bbl	RM55.10/bbl

Source: Sabah Shell Petroleum Company Limited and Shell Sabah Selatan Sdn Bhd and various

Additional 9,000bbls/day potential performance.

Core mission is to ensure it achieves a production level of 50mbbls of 2P reserves, translating to 10,000bbls/day of production.

Figure 6: DCF Valuation On North Sabah EOR PSC

Cost of Debt	5.0%
Cost of Equity	12.7%
Risk Free Rate	3.8%
Market Risk Premium	9.1%
Beta	1.0
Equity	77.8%
Debt	22.2%
Terminal rate	2.0%
WACC *	**11.0%**
Total DCF	**386.6**
No. of Shares ('000)	**1443.0**
Fair Value (USD)	***0.27***
Fair Value (RM) @ 4.10	**1.10**
Hibiscus Portion (50% interest) RM	**0.55**

Source: Public Investment Research estimates

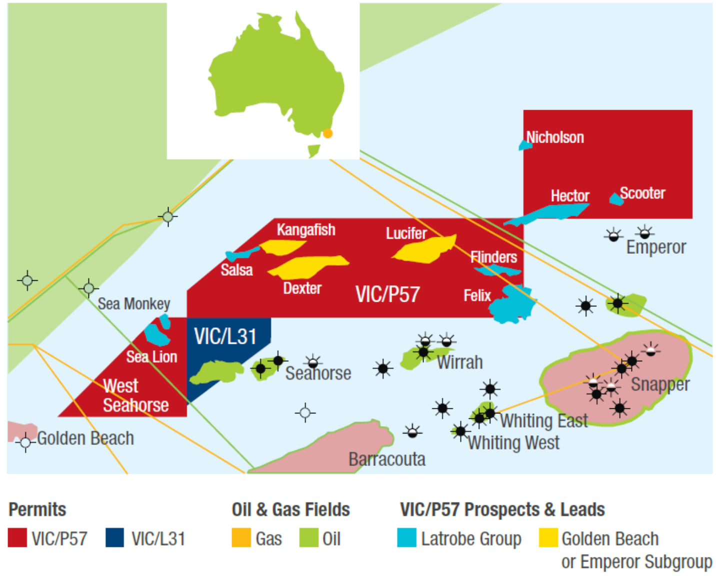
Additional 9,000bbls/day potential performance. We are most excited about the Group's prospects going forward, with the potential acquisition of Shell Malaysia's 50% stake in the North Sabah PSC with Petronas Carigali. The addition of North Sabah would see Hibiscus' performance increase to 57.7mbbls of 2P reserves, with 44.0mbbls of 2C resources and hence a collective 13,000bbls/day of production.

Target for 2016-2018. Hibiscus' core mission is to ensure it achieves a reserve level of 50mbbls of 2P reserves, translating to 10,000bbls/day of production. We understand they also have a strategic mission to add a further 50mbbls of 2P reserves/2C resources by 2020. With the completion of the potential North Sabah asset acquisition, the Group will successfully achieve its core mission and by more than 50%.

Future plans. Through its acquisition in the Bass Straits of Australia in January 2013, Hibiscus has a 78.3% effective interest as a concession operator in VIC/P57 (West Seahorse Field Exploration) and which comes with an exploration permit, and a 100.0% effective interest as a concession operator in VIC/L31 with a production license. We understand that the Group had drilled an exploration well in the Sea Lion prospect in 4Q 2015 which is a non-discovery well. Due to the weaker-than-expected oil price levels however, the Australian operations was placed on a halt.

For the West Seahorse Field, the Group has a development license whereby a field development planned has been approved with a production license obtained. Management has expressed that when oil prices stabilise at the USD60/bbl levels, a final investment decision will then be made, to ascertain economic viability of the field. Seahorse has an estimated 8mbbls of 2P+2C oil reserves. At the very least, even if the Group decides to dispose the asset, assuming oil price levels remain below USD60/bbl, we do expect the monetization of this asset to be positive for the Group for the longer-term.

Figure 7: VIC/P57 and VIC/L31 Map



Source: Company

VIC/P57 and VIC/L31 further details. Both VIC/P57 and VIC/L31 licenses for the respective fields are expiring on 9 January 2018 and 5 December 2018 respectively. We understand that Hibiscus has provided RM17.5m of impairments for the fields in FYE16, having determined that the recoverable amounts based on the DCF model are higher than the carrying amount for VIC/L31, but lower for VIC/P57. The carry value of the rights and concession is RM100.6m as at 30 June 2016. Both licenses for exploration and production are renewable with the Australian authorities.

Figure 8: Key Assumptions To Determine Recoverable Amount For VIC/P57 in FYE16

i) Discount rate of 11%;
ii) Prospective resources estimated by in-house geological and geophysical team;
iii) Exploration well costs of USD28m for a 1,800m depth for oil well (based on an external independent consultant report); and
iv) Brent oil price of USD69.27, USD78.81 and USD78.81 per bbl for 2019, 2020 and 2021 respectively and 2% premium to Brent oil prices.

Source: Annual Report

Figure 9: Key Assumptions To Determine Recoverable Amount For VIC/L31 in FYE16

i) Discount rate of 10%;
ii) 3 years projection from 2019 to 2021 which is the expected economic limit cut-off for the field;
iii) Total project capital expenditures of approximately USD69m (before the potential sale and leaseback of mobile offshore production unit rig);
iv) Oil production profile based on the assessment by independent oil and gas reserve experts;
v) Brent oil price of USD69.27, USD78.81 and USD78.81 per bbl for 2019, 2020 and 2021 respectively and 2% premium to Brent oil prices; and
vi) First oil being achieved in July 2019.

Source: Annual Report

INVESTMENT RISKS

Single income source. At this juncture, assuming Anasuria to be the bread and butter of Hibiscus for the longer-term. Any hiccups on this project would directly affect the Group's performance.

Non-approval from Petronas for Shell's 50% participating interest in the 2011 North Sabah EOR PSC. At this juncture, the acquisition is conditional to Petronas' approval. Assuming the non-approval, the Group's fair value for the interim will remain at RM0.60.

Oil price levels. An inevitable event, oil price fluctuations is a determining factor to the Group's performance.

FINANCIALS

The Group is currently in a net cash position, and is therefore able to gear up where needed for the future. As at 1QFY17 results, the Group has shown a boost in earnings from its deferred taxation. Stripping off the reversal of deferred taxation, the Group's earnings would register a better net loss position of RM6.7m, which we are positive would continue in an upward trend as performance will be driven by the higher, current stable oil price levels, and with all expected one-offs to have been accounted for.

How is income derived? Revenue is accounted when oil or gas is lifted by the buyer (off take) at most commonly a spot price. Then energy royalty (if any) is deducted, followed by the lifting cost. At the EBITDA level, CAPEX, OPEX and all taxes are deducted before earnings are recognized.

Valuation – fair value of RM0.60. We value Hibiscus' 50% stake in Anasuria Cluster at RM0.60 based on our DCF valuation with an 11.0% WACC. The Group currently owns and operates the field together with Ping Petroleum Limited. Our valuation has accounted for the decommissioning capex and various taxes.

Decommissioning capex. As part of the Decommissioning Security Agreement (DSA), it is the Group's obligation to dismantle and remove the facility, and to restore the site on which it is located. The estimated decommissioning cost and restoration of RM257m is discounted to its net present value. We understand that this amount is the discounted initial provision for decommissioning costs capitalised and amortised over the life of the Anasuria cluster fields on a unit of production basis over the proven and probably developed reserves.

Contingent consideration. We do note that there is a contingent consideration to the vendors, if oil price is above USD75/bbl, but only for between 2018-2021. The contingent consideration is 15cents per USD/bbl. Factoring in this consideration and with the assumption that oil price is at USD75/bbl from 2018 to 2035, Hibiscus' portion of the Anasuria Cluster is worth RM1.03 with the above assumptions remaining unchanged.

Taxation effects. We observe that as of 1QFY17, the Group's taxation in its profit and loss statement included an RM75.8m deferred taxation which is the reversal of the deferred tax liabilities. This is following the adjustment of the fiscal terms of the UK North Sea Tax Regime in UK's Finance Bill 2016, accounting for a downward revision of supplementary charge tax rate from 20% to 10%. Supplementary assessment shows the increase in value of an asset during the current tax year. This occurs where new infrastructure is completed or occupied during the current tax year. A Supplementary assessment is also calculated when a major renovation or addition is completed on an existing asset.

KEY FINANCIAL TABLE (RM m)

FYE Jun (RM m)	2015A	2016A	3QFY16	4QFY16	1QFY17
Revenue	15.6	81.7	31.8	50.6	54.7
Gross Profit	15.6	40.9	8.0	32.3	30.5
Pre-tax Profit	-75.8	-56.3	79.8	23.2	7.5
Net Profit	-74.2	-60.0	80.5	19.0	80.3
Core Net Profit	-67.9	-176.0	-68.2	-129.9	-6.7
EPS (Sen)	-9.7	-5.7	7.3	1.6	5.9
P/E (x)	n/a	n/a	5.8	18.1	17.2
DPS (Sen)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company

RATING CLASSIFICATION

STOCKS

OUTPERFORM	The stock return is expected to exceed a relevant benchmark's total of 10% or higher over the next 12months.
NEUTRAL	The stock return is expected to be within +/- 10% of a relevant benchmark's return over the next 12 months.
UNDERPERFORM	The stock return is expected to be below a relevant benchmark's return by -10% over the next 12 months.
TRADING BUY	The stock return is expected to exceed a relevant benchmark's return by 5% or higher over the next 3 months but the underlying fundamentals are not strong enough to warrant an Outperform call.
TRADING SELL	The stock return is expected to be below a relevant benchmark's return by -5% or more over the next 3 months.
NOT RATED	The stock is not within regular research coverage.

SECTOR

OVERWEIGHT	The sector is expected to outperform a relevant benchmark over the next 12 months.
NEUTRAL	The sector is expected to perform in line with a relevant benchmark over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform a relevant benchmark over the next 12 months.

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