

Rockhopper Exploration

Market heavily discounting Sea Lion

Sea Lion update

Oil & gas

Based on our analysis, we believe the current share price implies a c 20% chance of success for Sea Lion Phase 1 at \$70/bbl or c 39% at a \$60/bbl long term oil price (excluding any value for further phases of Sea Lion). Given recent progress with the award of letters of intent (LOIs) for key project components and with more than 60 people working on the development, we are more positive on the chance of success. In our view, the key outstanding risks are in project funding and politics. H119 has the potential to be eventful for Rockhopper with more definitive guidance on the availability of export credit funding and a hearing on the Ombrina Mare arbitration, scheduled for February. Our valuation increases to 78.9p/share (+7.2%) largely due to sterling weakness. This valuation assumes a 55% chance of Sea Lion Phase 1 progressing and 20% for subsequent phases at a \$70/bbl long-term oil price. Given the subjectivity of key inputs, we provide sensitivities to these key value drivers in this note.

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	10.8	(10.6)	7.4	40.1	(18.0)
12/19e	10.0	(8.1)	3.8	20.0	(24.0)

Note: Figures as reported

Sea Lion remains a key growth project for Premier

Sea Lion features as Premier Oil's (PMO) next major growth project beyond Tolmount, while appraisal at Zama resumes. We believe Zama offers a more liquid exit opportunity for Premier on completion of the current appraisal campaign; although Premier's high equity interest (60%) in Sea Lion has proved to be less liquid, it provides an opportunity for the group to replicate its FPSO project execution success at Catcher. We estimate a net unlevered, point-forward IRR for Premier of 23% for Phase 1 development at \$70/bbl Brent.

Key remaining project risks

We see the key outstanding risks for Sea Lion Phase 1 as funding and political. It is difficult to quantify these risks, but we understand that export credit/debt finance processes are ongoing, although the timetable remains uncertain, and the recent introduction of a second weekly flight between South America and the Falklands suggests a potential improvement in cross-Atlantic relationships. While we use a 55% chance of success for Phase 1, this is subjective; hence we provide sensitivities to this in the valuation section of this note.

Valuation: Market implies 20% chance of success

Based on our oil price deck of \$70/bbl Brent in the long term, we believe the market is implying just c 20% chance of success for Phase 1 and zero value for subsequent development phases, which we feel to be overly pessimistic.

23 January 2019

Price 23.28p

Market cap £106m

\$/£0.77

Net cash (\$m) at December 2018 40.4

Shares in issue 457.4m

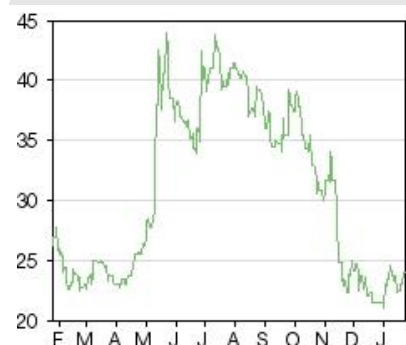
Free float 98.9%

Code RKH

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 11.6 (26.7) (7.3)

Rel (local) 7.9 (25.4) 3.4

52-week high/low 44.0p 20.2p

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

Funding progress H119

Ombrina Mare arbitration outcome Mid-2019

Sea Lion FID 2019

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Sea Lion heavily discounted

At the current share price, it appears the market has substantially discounted Sea Lion despite operator Premier Oil's apparent commitment to the project. Below we outline what we feel are the key risks and uncertainties in relation to the development of Sea Lion, and we take a view on what the market is implying in terms of oil price expectations and chances of the project progressing.

Sea Lion key risks

Premier Oil's commitment to Sea Lion

Premier has signed LOIs with the Sea Lion FPSO provider, drilling contractor, subsea equipment provider, well services, subsea installation contractor and for helicopter services alongside building a development team of more than 60 people. In our view, Premier is committed to progressing Sea Lion through to first oil; delivery of FPSO development, Catcher, on time and 30% below budget will provide Premier's management with comfort in its execution capabilities.

Project threshold for commerciality: Premier Oil returns

Premier's unlevered returns on Sea Lion Phase 1 will be to a large extent driven by oil the price, assuming cost to first oil can be maintained at \$1.5bn gross. Below we provide our calculation of Premier's point-forward returns at various long-term oil price expectations. We note that the project delivers unlevered IRRs over 20% to Premier at oil prices above \$60/bbl in the long term (levered IRRs will depend on the cost of debt but are likely to be materially higher). In our view, our modelled levered returns should enable Premier Oil to justify investment at current spot oil prices.

Exhibit 1: Unlevered point-forward IRRs for Sea Lion Phase 1					
Oil price LT (Brent \$/bbl)	50	60	70	80	90
PMO IRR	16%	20%	23%	25%	27%
RKH IRR	22%	27%	32%	35%	39%

Source: Edison Investment Research

Securing project funding

A key investment consideration has been Premier Oil's ability to fund the development of Sea Lion given its existing net debt and associated debt covenants. Funding for the project is expected to be split into vendor financing (c \$375m), export credit/bank finance (c \$750m) and upstream partner equity (c \$375m). With Premier estimating end-FY18 net debt at \$2.3bn and a year-end leverage ratio of 3x net/EBITDA, it remains well within its 5x covenant. Premier has committed to further reductions in covenant ratio (targeting net debt/EBITDA at 2.7x by end Q119) and this can be achieved by several means including a covenant-accretive transaction (Premier has said it continues to look at North Sea assets – we expect producing asset packages that can accelerate the monetisation of Premier's tax loss position) or, alternatively, a sizeable asset divestment.

In our view, Premier's 25% equity interest in Mexico Block 7, containing the Zama discovery, makes an attractive divestment opportunity post appraisal. We see equity in Zama as a liquid asset, demonstrated by the recent sale of Sierra Oil and Gas's stake in the discovery.

DEA recently acquired Sierra Oil and Gas for c \$500m (according to press reports). DEA has a 40% interest in the Zama discovery, which contains a Premier estimated 400–800mmbbls (P90-P10) recoverable. Although it is unclear exactly how much of the deal value is for Sierra's net stake in Zama and/or cash held in the company, it does suggest there is sufficient industry interest in the discovery to enable Premier to transact.

On the other hand, we see Sea Lion as a less-liquid asset for Premier, largely due to jurisdiction. Nevertheless, risked returns for operator Premier Oil remain compelling at current oil prices. We estimate that Premier will generate a point-forward, unlevered 23% IRR based on its 60% working interest, based on a \$70/bbl long-term oil price and after Rockhopper's (RKH) cost-carry for Phase 1. This return is highly geared to underlying oil price assumptions, as can be seen in Exhibit 1. Rockhopper is funded for Phase 1 development of Sea Lion through existing cost-carry arrangements with Premier Oil.

We see some risk and uncertainty around the availability and timing of export credit/debt financing given the political backdrop. This is a key component of our project risking.

Technical risks

Sub-surface technical risks that can derail Sea Lion Phase 1 have been largely mitigated through an extensive appraisal programme. Operational risks remain, as with any development project, but existential risks are within the normal bounds expected for an offshore project of this nature.

Government approvals

The Falkland Islands government (FIG) is fully behind the development of Sea Lion and has shown its support in providing the required exploration, appraisal and development consent. We see the risk of FIG objecting to the project as minimal. The project FDP is substantially agreed and a final update is expected on project sanction. The Environmental Impact Statement (EIS) public consultation process has been completed.

Perceived political risks

Geopolitical risks are hard to dismiss completely, especially with varying views on the sovereignty of the Falklands among senior political figures on both sides of the Atlantic. Relationships have improved in recent months with the introduction of a second flight a week from South America (Sao Paulo via Cordoba in Argentina to Mount Pleasant in the Falklands) to the Falklands.

Sea Lion uncertainties

Timeline to first oil

Assuming Sea Lion is sanctioned and reaches final investment decision (FID) in H219, it is possible for first oil to be achieved in 2023 (assuming a 3.5-year project timeline). We add an additional element of conservatism in our base, assuming first oil in mid-2024. Slippage beyond this would likely be driven by funding/political delays rather than project execution.

Oil price and economics

We assume a \$70/bbl long-term oil price in our base case and provide valuation sensitivities to commodity price. The oil price is a key driver of net project economics. Premier estimates total life of field opex and capex per barrel at \$35/bbl and the full-cycle project break-even oil price varies between Premier and Rockhopper due to existing cost-carry arrangements. Gearing to the oil price is similar to that expected for North Sea FPSO developments.

Capex costs

LOIs with key service companies provide a basis for capex cost estimates of \$1.5bn gross before first oil. Higher oil prices and an inflationary environment could lead to cost creep. At our base case \$70/bbl long-term oil price and with spot prices remaining below this level, we do not expect a significant change to Premier's current cost estimate.

Subsurface

Reservoir-related uncertainty is relatively constrained given that Sea Lion has been extensively appraised. We do not see this as outside the normal range for a project moving into development.

Other uncertainties: Production, fiscal and oil price benchmark/discount

Other key uncertainties are within the normal range we would expect for a project of this nature.

Ombrina Mare and Abu Sennan

Egypt and Italy are relatively small components in our overall Rockhopper valuation, at 3% and 4% respectively. Recent operational updates highlight a couple of recent positive developments in relation to both.

Ombrina Mare, Italy

Rockhopper commenced international arbitration proceedings against the Republic of Italy in relation to the Ombrina Mare field it acquired from Mediterranean Oil & Gas in 2017. Rockhopper believes it has strong prospects of recovering 'significant monetary damages' based on lost profits as a result of the Republic of Italy's breaches of the Energy Charter Treaty. We estimate this will be recoverable at c \$16m on a risked basis in our valuation but press reports suggest it could be materially higher with the claim running up to several hundreds of millions of euros. The hearing is scheduled for early February 2019.

Abu Sennan, Egypt

Average production rates for Abu Sennan in FY18 were 840boed net and Rockhopper expects to sustain current production levels in FY19, on inclusion of recent success at Al Jahraa-10. We forecast 840boed in FY19, a 6% increase on previous forecasts, and a slightly higher liquids yield than in FY18 (on inclusion of production from Abu Roash-C, which flowed at 130bopd gross). Rockhopper has joint venture approval for an active 2019 drilling programme which includes one exploration well, two development wells and a water injector. Drilling is expected to commence in Q119. Rockhopper's Egyptian receivables position has reduced materially over the course of FY18, from \$7.5m at the end FY17 to \$1.5m at end FY18.

Valuation: Sea Lion risking and oil price key drivers

Our base case valuation increases by 11.7% from 73.6p/share to 82.2p/share (+5.0% in dollar terms). Sterling foreign exchange rates remain volatile ahead of Brexit (our FX assumption moves from £/\$0.75 to 0.77 based on recent sterling weakness). Other key moving parts in our valuation are described below.

Key changes to valuation

Oil pricing: we move our short-term oil price deck from \$70.6/bbl to \$60.5/bbl for FY19, which affects Egyptian oil realisations, but our long-term oil price expectation of \$70/bbl Brent in 2022 remains unchanged. We upgrade our Abu Sennan production profile, increasing our FY19 production expectation by 6% with a higher liquids yield, offsetting our lower FY19 oil price assumption.

FX: moves from £/\$0.75 to 0.77 based on recent sterling weakness.

First oil: we move Sea Lion Phase 1 first oil from mid-2023 to mid-2024, essentially including a one-year contingency over and above management guidance. We also move subsequent phases back by one year.

Rolling forward of NAV: we roll forward our discount date for future cash flows from 1 January 2018 to 1 January 2019, largely offset by the one-year delay to first oil included in our update.

NAV breakdown by asset

A full breakdown of our valuation by asset is provided in the exhibit below, including a sensitivity to our underlying cost of capital assumption of 12.5%.

Exhibit 2: Edison breakdown of Rockhopper NAV												
Asset	FX US\$/£0.77				Recoverable reserves			Net risk value at WACC of 12.5%				
	Shares: 457m	First	WI	CoS	Gross	Net	NPV					
	Country	production	%	%	mmboe	mmboe	\$/boe	\$m	p/share	10%	15%	20%
Net (debt)/cash - Dec 2018								40	6.8	6.8	6.8	6.8
G&A (NPV12.5 of 5 years)								(21)	(3.5)	(3.5)	(3.5)	(3.5)
Production												
Guendalina	Italy		20%	100%	0.8	0.2	23.2	4	0.6	0.6	0.6	0.6
Abu Sennan	Egypt		22%	100%	10	2.3	6.7	15	2.6	2.9	2.3	1.9
Civita	Italy		100%	100%	0.1	0.1	-22.2	(1)	0.0	0.0	0.0	0.0
Development												
Sea Lion Phase 1	Falkland Islands	2024	40%	55%	221	88	5.3	256	43.2	58.0	32.0	17.0
Sea Lion Phase 2 in PL32	Falkland Islands	2029	40%	20%	87	35	4.6	32	5.4	8.2	3.6	1.6
Sea Lion Phase 2 in PL04	Falkland Islands	2029	64%	20%	214	137	4.6	125	21.2	32.0	14.0	6.1
Ombrina Mare - under arbitration	Italy							16	2.7	2.7	2.7	2.7
Riskd NAV					533	262		466	78.9	107.6	58.5	33.1
Source: Edison Investment Research												

What is the market implying?

With Rockhopper currently trading at 23p/share, the market is much more pessimistic on Sea Lion Phase 1 progression or oil price expectations than our base case 55% commercial chance of success (CoS) based on a long-term price expectation of \$70/bbl Brent. The current share price suggests an implied chance of success of c 20% for Phase 1 at \$70/bbl or c 39% at \$60/bbl (see Exhibit 3), implying that the project is unlikely to proceed. Based on our analysis of the key risks and assuming a long-term oil price of \$70/bbl, we believe the project is more likely to proceed than not. However, timeline uncertainty remains with funding on the critical path.

Exhibit 3: RKH core asset and Sea Lion Phase 1 valuation sensitivity					
Phase 1 CoS/ Brent \$/bbl LT	50	60	70	80	90
10%	6.5	10.4	14.3	18.1	21.9
20%	7.6	14.9	22.2	29.3	36.3
30%	8.6	19.3	30.0	40.5	50.8
40%	9.7	23.8	37.9	51.7	65.2
50%	10.7	28.2	45.7	62.8	79.7
Source: Edison Investment Research					

Financials: Funded to Sea Lion Phase 1 first oil

Rockhopper expects to end FY18 with c \$40m of cash on the balance sheet and no debt (in line with our forecasts). With SG&A running at c \$4.5m pa and non-Sea Lion capital costs covered by c \$3–\$4m of positive cash flow from operations, Rockhopper should be funded through to Sea Lion Phase 1 first oil given current operator estimates of the project's debt capacity. In addition, Rockhopper retains outstanding cost-carry balances for Phase 2 Sea Lion development and,



depending on the precise capex schedule to this development phase, is likely to fund its share of development through a combination of existing carries and cash flows from Phase 1. Alternatively, equity in a producing Phase 1 Sea Lion development will provide the company with access to a borrowing base if Rockhopper looks to debt fund further phases.

Exhibit 4: Financial summary

Accounts: IFRS, Yr end: December, USD: Thousands	2015A	2016A	2017A	2018E	2019E	2020E
Total revenues	3,966	7,417	10,401	10,797	9,982	9,059
Cost of sales	(11,049)	(7,667)	(9,573)	(5,892)	(5,135)	(5,443)
Gross profit	(7,083)	(250)	828	4,905	4,847	3,616
SG&A (expenses)	(10,895)	(9,970)	(5,282)	(4,570)	(4,684)	(4,801)
Other income/(expense)	(22,934)	(8,237)	(3,422)	(3,975)	0	0
Exceptionals and adjustments	(10)	116,527	(1,830)	(490)	(1,246)	(1,296)
Reported EBIT	(40,922)	98,070	(9,706)	(4,130)	(1,083)	(2,481)
Finance income/(expense)	975	307	783	717	196	0
Other income/(expense)	(4,750)	(333)	(39)	(7,205)	(7,171)	(8,067)
Exceptionals and adjustments	0	0	0	0	0	0
Reported PBT	(44,697)	98,044	(8,962)	(10,618)	(8,058)	(10,548)
Income tax expense (includes exceptionals)	55,395	0	2,823	(25)	0	0
Reported net income	10,698	98,044	(6,139)	(10,643)	(8,058)	(10,548)
Basic average number of shares, m	293	446	457	457	457	457
Basic EPS	3.7	22.0	(1.3)	(23.3)	(17.6)	(23.1)
Adjusted EBITDA	(32,814)	(15,163)	(2,403)	(1,111)	2,977	2,222
Adjusted EBIT	(49,010)	(21,751)	(13,349)	(6,169)	(2,652)	(4,593)
Adjusted PBT	(52,785)	(21,777)	(12,605)	(12,657)	(9,626)	(12,660)
Adjusted EPS (c)	120	(13)	(5)	(12)	(13)	(19)
Adjusted diluted EPS (c)	120	(13)	(5)	(12)	(13)	(19)
Balance sheet	2015A	2016A	2017A	2018E	2019E	2020E
Property, plant and equipment	12,637	18,025	11,585	12,610	30,610	32,883
Goodwill	0	0	0	0	0	0
Intangible assets	256,658	426,419	432,147	439,641	442,781	441,054
Other non-current assets	9,803	9,439	10,789	10,508	10,508	10,508
Total non-current assets	279,098	453,883	454,521	462,759	483,899	484,445
Cash and equivalents	110,434	81,019	50,729	40,075	30,000	30,000
Inventories	1,670	1,608	1,621	1,579	1,579	1,579
Trade and other receivables	6,199	17,184	16,840	9,385	9,385	9,385
Other current assets	2,192	495	4,354	4,746	4,746	4,746
Total current assets	120,495	100,306	73,544	55,785	45,710	45,710
Non-current loans and borrowings	0	0	0	0	9,952	10,930
Other non-current liabilities	106,893	93,174	85,245	91,289	98,459	106,526
Total non-current liabilities	106,893	93,174	85,245	91,289	108,411	117,456
Trade and other payables	30,457	34,012	12,772	6,739	6,739	6,739
Current loans and borrowings	0	0	0	0	0	0
Other current liabilities	9	9	9,450	9,064	9,064	9,064
Total current liabilities	30,466	34,021	22,222	15,803	15,803	15,803
Equity attributable to company	262,234	426,994	420,598	411,452	405,394	396,896
Non-controlling interest	0	0	0	0	0	0
Cashflow statement	2015A	2016A	2017A	2018E	2019E	2020E
Profit for the year	(44,697)	98,044	(8,962)	(10,618)	(8,058)	(10,548)
Taxation expenses	0	0	0	0	0	0
Net finance expenses	3,942	16	(743)	6,371	6,975	8,067
Depreciation and amortisation	2,744	4,725	5,687	2,575	2,860	3,454
Share based payments	1,937	994	864	1,244	2,000	2,050
Other adjustments (impairments)	26,075	(115,546)	5,652	2,827	0	0
Movements in working capital	3,143	(9,433)	(868)	5,000	0	0
Interest paid / received	0	0	0	0	0	0
Income taxes paid	0	0	0	0	0	0
Cash from operations (CFO)	(6,856)	(21,200)	1,630	7,399	3,777	3,022
Capex	(80,919)	(40,203)	(26,817)	(17,960)	(24,000)	(4,000)*
Acquisitions & disposals net	0	(13,527)	(6,266)	(658)	0	0
Other investing activities	39,791	77,755	521	532	196	0
Cash used in investing activities (CFIA)	(41,128)	24,025	(32,562)	(18,086)	(23,804)	(4,000)
Net proceeds from issue of shares	(2,733)	0	0	0	0	0
Movements in debt	0	0	0	0	9,952	978
Other financing activities (includes rig settlement)	2,219	(2)	(13)	10	0	0
Cash from financing activities (CFF)	(514)	(2)	(13)	10	9,952	978
Increase/(decrease) in cash	(48,498)	2,823	(30,945)	(10,677)	(10,075)	0
Currency translation differences and other	(794)	(2,238)	655	23	0	0
Cash at end of period	50,434	51,019	20,729	10,075	0	0
Net (debt) cash including term deposits	110,434	81,019	50,729	40,075	20,048	19,070

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

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