

# Rockhopper Exploration

Farm-down

## Sea Lion funding outlook strengthened

Rockhopper (RKH) has announced that, together with Premier Oil, it has signed Heads of Terms with Navitas Petroleum to farm down a 30% interest in the Sea Lion project. The deal increases confidence that project debt financing to the joint venture can be secured successfully for Sea Lion Phase 1 of development, while Rockhopper maintains a material 30% stake in Sea Lion, and Premier 40% and operatorship. Rockhopper's share of project costs will now be covered from 1 January 2020 through to Phase 1 completion, pending sanction. Meanwhile, partner Premier has announced a series of significant North Sea M&A deals, which materially strengthen its balance sheet and further support the Sea Lion project financing discussions. We update our valuation to account for the farm-down deal and roll forward the discount date, resulting in a risked valuation of 53.7p/share, down from 79.6p/share.

Year-end	Revenue (US\$m)	PBT* (US\$m)	Cash from operations (US\$m)	Net cash** (US\$m)	Capex** (US\$m)
12/17	10.4	(9.0)	1.6	50.7	(26.8)
12/18	10.6	(7.1)	5.4	40.4	(15.8)
12/19e	10.4	(2.3)	0.9	17.8	(19.0)
12/20e	2.2	(10.0)	(0.1)	14.6	(15.0)

Note: \*PBT normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. \*\*Assumes capex ahead of first oil funded by Premier and Navitas interest-free loan from 1 January 2020.

## Rockhopper fully funded for Sea Lion Phase 1

The entry of Navitas into the Sea Lion joint venture (JV) brings incremental equity and debt financing to the project, leading to greater certainty that project financing can be delivered. Rockhopper has protected its balance sheet while retaining a 30% stake and is now funded by a combination of Premier Oil and Navitas Petroleum interest-free loan from 1 January 2020 to Phase 1 project completion.

## JV balance sheets shielded to unlock debt funding

Premier's UK North Sea M&A deal will provide additional cash flow that will accelerate the company's debt reduction, increasing the likelihood that project finance can be secured for Sea Lion Phase 1. Meanwhile, the preliminary information memorandum (PIM), submitted by the Sea Lion JV to potential providers of senior debt project finance in August 2019, is now also likely to progress, having been held up in Whitehall due to the general election.

## Valuation: Market implies heavy discount on Sea Lion

Our valuation suggests that the equity market is more optimistic towards Sea Lion Phase 1 sanction, implying an increased chance of success of 30% vs 20% at the time of our [last note](#). Our updated risked valuation accounts for the new Heads of Terms, consequent participating interest readjustment and new interest-free loan to fund Rockhopper towards Phase 1 project completion. Our risked valuation now stands at 53.7p/share based on a Sea Lion Phase 1 CoS of 55%. We provide sensitivities to Phase 1 CoS and will publish a more detailed review once funding has been secured.

Oil & gas

10 January 2020

Price **20.2p**

Market cap **£93m**

US\$1.26/£

Net cash (\$m) at 30 June 2019 27

Shares in issue 457.8m

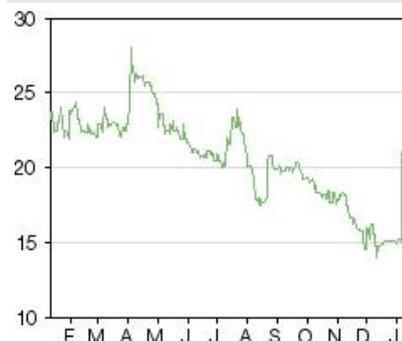
Free float 99%

Code RKH

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 34.4 7.5 (17.0)

Rel (local) 28.2 0.2 (25.4)

52-week high/low 28p 14p

### Business description

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

### Next events

Ombrina Mare arbitration outcome Q120

SPA signing Q120

Farm-in completion Q220

Sea Lion Phase 1 FID H220

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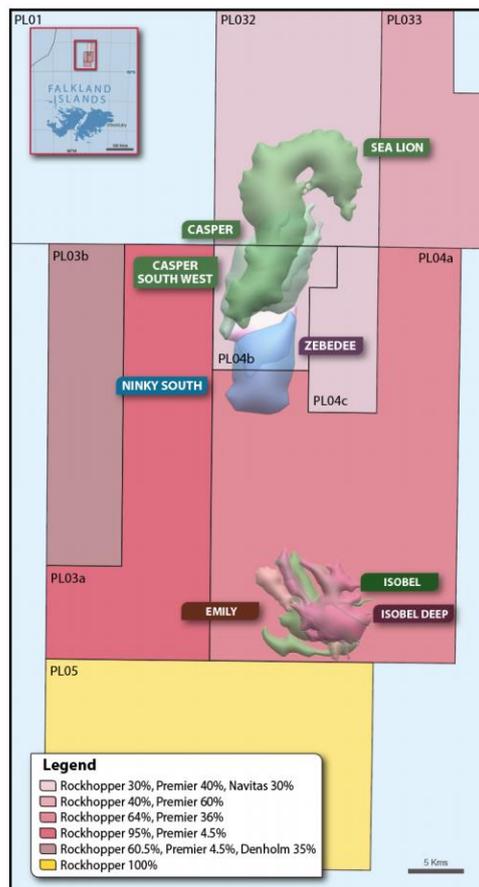
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## Navitas Petroleum to acquire 30% interest in Sea Lion

The entry of an additional partner into the JV brings further industry validation and improves the likelihood of securing project financing for Phase 1 of the Sea Lion development. Rockhopper is now fully funded from the start of 2020 through to completion of Phase 1 of the project, which will develop 250mmbbls of gross resources. In addition, a contingent consideration of up to \$48m is payable to Rockhopper by Premier Oil and Navitas for future phases of development in the North Falkland Basin.

Under the terms of the transaction, Navitas will acquire a 30% interest in the PL032, PL004b and PL004c Sea Lion licences, leaving Rockhopper with 30% and Premier with 40% (and operatorship) across all three licences. This alignment will simplify and streamline commercial arrangements across the JV and avoid a potentially intricate unitisation among licences. Rockhopper will also receive contingent payments of up to \$36m from Premier's and Navitas's share of Phase 2 cash flows, linked to production performance. Phase 2 will commercialise a further c 300mmbbls gross resources focused in the southern part of Sea Lion straddling PL032 and PL004, and including the Zebedee discovery, and is expected onstream five years after Phase 1 start-up.

**Exhibit 1: Rockhopper North Falkland Basin licences**



Source: Rockhopper Exploration

The deal does not cover licence PL004a, in which Rockhopper currently holds a 64% working interest. However, it does include an option for Navitas and Premier to acquire working interests in PL004a (of 30% and 4% respectively) and further align working interests across PL032 and PL004. Navitas and Premier would pay a consideration of \$12m from their shares of Phase 3 cash flows. The licence area holds the oil-bearing Isobel-Elaine complex.

Finalisation of the sale and purchase agreement is expected during Q120. The farm-down completion, targeted for Q220, is conditional on the approval of the Falkland Islands Government. Following completion, but prior to 1 April 2021, Navitas can exercise a withdrawal right, subject to certain conditions, including a Phase 1 final investment decision (FID) not having been taken.

The progress of the PIM, a key milestone towards FID for Sea Lion, was held up as a result of the general election, but is now expected to move forward as new ministerial appointments are made.

## **Navitas: North America-focused asset portfolio**

Navitas Petroleum is an oil and gas E&P partnership mainly focused on North America. The company's production assets include the conventional onshore Neches field, and the offshore Buckskin field, while the offshore Shenandoah project is at the development stage. Shenandoah is expected to take the company's production to more than 40,000bopd by 2023. Navitas also holds high-impact exploration prospects offshore Canada, in Block 7. The company is publicly traded on the Tel Aviv Stock Exchange and its chairman, Gideon Tadmor, was CEO and Chairman of Delek Group's upstream companies, where he was instrumental in the discoveries of the multi-tcf Tamar and Leviathan fields.

## **Premier deals to strengthen financial position**

Rockhopper's JV partner Premier has also announced the proposed UK North Sea acquisitions of the Andrew and Shearwater fields from BP for \$625m and an additional 25% interest in the Premier-operated Tolmount Area from Dana for \$191m plus contingent payments of up to \$55m. The additional free cash flow that will be generated by these assets will accelerate debt reduction and the company estimates that it will significantly reduce its forward covenant leverage ratio towards 1x by 2021. However, Asia Research and Capital Management (ARCM), which has had a growing short position in Premier shares since 2017, and describes itself as Premier's largest creditor, said it would 'take all steps' to oppose the North Sea deals. Premier expects to confirm details of the issue in Q120. Assuming the deal is completed, strengthening the company's financial position should further support the Sea Lion project finance discussions.

## **Ombrina Mare arbitration**

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In March 2017, Rockhopper started international arbitration proceedings against the Republic of Italy in relation to the Ombrina Mare field it acquired from Mediterranean Oil & Gas. 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 \$20m on a risked basis in our valuation using a simplified approach, which assumes a 50% chance of recovering the associated acquisition costs. We have not carried out a loss of profits calculation but press reports suggest it could be materially higher, with the claim running up to €275m plus interest. Clearly, there is material upside to our valuation in the event of a damages award to Rockhopper. Indicatively, a \$50m award to Rockhopper net of costs would be worth up to 8.5p/share to equity holders. On 26 June 2019, the tribunal rejected Italy's request for the suspension of the arbitration and Italy's intra-EU jurisdictional objections. Rockhopper expects a final outcome and potential damages award in the next three to six months.

## Valuation

We value Rockhopper's asset base using a conventional risked net asset value (NAV) approach, based on a risked valuation for proven reserves, and contingent and prospective resources. Key assumptions in our valuation include estimates of production profiles, asset development costs and operational costs in addition to realised commodity prices and costs of capital. We use publicly available sources for key assumptions, including company guidance.

We have updated our forecasts and NAV to reflect the Heads of Terms agreed between Rockhopper, Premier Oil and Navitas, in which RKH's participating interest in Sea Lion licences was settled at 30%, the same as Navitas, while Premier retains 40% and remains the operator of the licences. As per the agreement, RKH will be funded by Premier and Navitas from 1 January 2020 to Phase 1 project completion (estimated to occur 9–12 months after first oil from Phase 1). The company was granted an interest-free loan by its partners to fund project development, which will be repaid from 85% of Rockhopper's working interest share of free cash flow. We assume FID will be taken in H220 and first oil for Sea Lion Phase 1 in mid-2024. We continue to base our valuation on a long-term oil price expectation of \$70/bbl Brent from 2022 inflated at 2.5% onwards. The NAV table below, in Exhibit 2, provides a breakdown of our valuation by asset.

**Exhibit 2: Edison breakdown of Rockhopper NAV**

Asset	Country	First oil	WI	CoS	Recoverable reserves		NPV	Net risked value				
					Gross	Net			12.5%	10.0%	15.0%	20.0%
			%	%	mmboe	mmboe	\$/boe	\$m	p/share	p/share	p/share	p/share
Net cash at 31 December 2019e								18	3.1	3.1	3.1	3.1
SG&A (NPV <sub>12.5</sub> of 5 years)								(24)	(4.2)	(4.2)	(4.2)	(4.2)
Proceeds from Abu Sennan disposal								12	2.1	2.1	2.1	2.1
<b>Production</b>												
Civita	Italy		100%	100%	0.0	0.0	(96.7)	(2)	0.0	0.0	0.0	0.0
Guendalina	Italy		20%	100%	0.4	0.1	18.5	2	0.3	0.3	0.3	0.3
<b>Development</b>												
Sea Lion Phase 1	Falkland Islands	2024	30%	55%	249	75	4.8	197	34.2	43.8	26.9	17.0
Sea Lion Phase 2 in PL32	Falkland Islands	2029	30%	20%	87	26	4.8	25	4.3	6.4	2.9	1.3
Sea Lion Phase 2 in PL04	Falkland Islands	2029	30%	20%	214	64	4.8	61	10.6	15.7	7.1	3.2
Ombrina Mare - under arbitration*	Italy							20	3.5	3.5	3.5	3.5
<b>Core NAV</b>					<b>551</b>	<b>165</b>		<b>308</b>	<b>53.7</b>	<b>70.6</b>	<b>41.6</b>	<b>26.2</b>

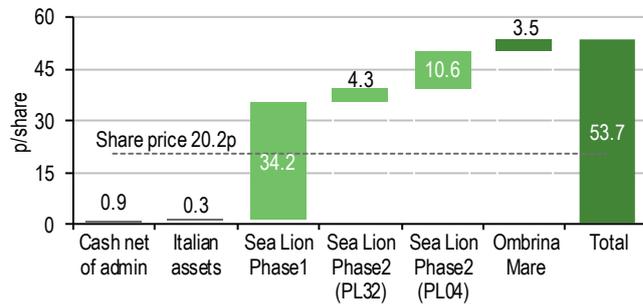
Source: Edison Investment Research. Note: Number of shares: 457.8m; FX = US\$1.26/£. \*Based on 50% chance of recovering acquisition cost rather than risked recovery of loss of profit.

Rockhopper currently trades at 20.2p/share relative to our risked valuation of 53.7p/share. Even though an increase in the share price was observed following the deal announcement, the equity market still appears to be taking a more pessimistic view of Sea Lion Phase 1 and/or lower oil price expectations compared with our base case. The current share price suggests an implied chance of success of c 30% for Phase 1 at \$70/bbl or c 55% at \$60/bbl, similar to current oil prices. We believe the project is more likely to proceed than not, now reinforced by the Navitas deal, hence our 55% commercial chance of success for Phase 1.

**Exhibit 3: Core assets and Sea Lion Phase 1 sensitivity**

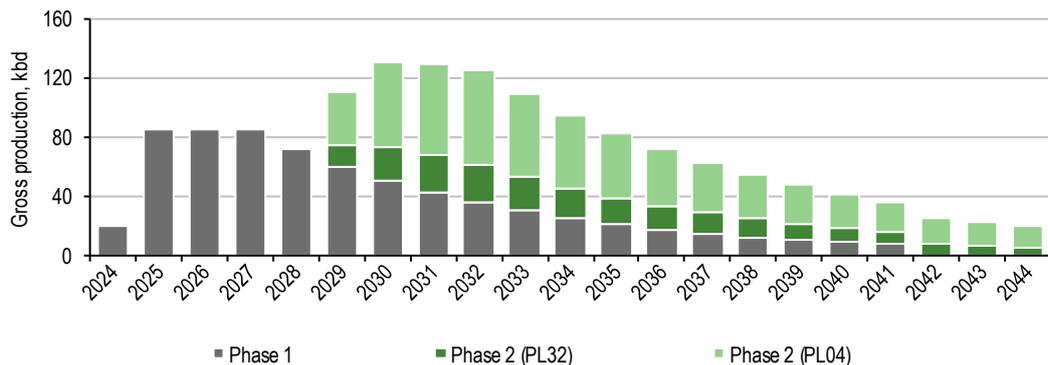
Phase 1 CoS/ Brent \$/bbl LT	50	60	70	80	90
10%	3.3	4.8	7.4	10.1	12.7
20%	5.4	8.4	13.6	18.9	24.3
30%	7.5	12.1	19.8	27.8	35.8
40%	9.6	15.7	26.0	36.7	47.4
50%	11.7	19.3	32.3	45.6	58.9
55%	12.7	21.1	35.4	50.0	64.7

Source: Edison Investment Research

**Exhibit 4: Rockhopper NAV waterfall**


Source: Edison Investment Research

Our estimated production profile is in line with company guidance for c 250mmbbls in Sea Lion Phase 1 and c 300mmbbls in Sea Lion Phase 2. Sea Lion Phase 2 is estimated to come online approximately five years from first oil at Phase 1. However, there is no development plan in place for the project. As per the agreed deal with Navitas, the existing funding arrangements between Rockhopper and Premier will be replaced for Phase 2. Rockhopper will receive contingent payments of up to \$36m from Premier's and Navitas's share of Phase 2 cash flows, linked to the achievement of certain production and oil price milestones.

**Exhibit 5: Edison gross production profile for Sea Lion Phases 1 and 2**


Source: Edison Investment Research

## Financials

Rockhopper ended H119 with c \$27m of cash on the balance sheet and no debt, in line with our estimates. With the disposal of Abu Sennan, our forecast Italian asset capex and SG&A are covered for the coming years at c \$5.4m pa. As a consequence of the Navitas farm-in, Rockhopper is fully funded through to Sea Lion Phase 1 project completion given the newly agreed interest-free loan from Navitas and Premier. We are accounting for this partnership loan in the company's balance sheet; however, we do not believe Rockhopper will need to access any additional funding for Sea Lion Phase 1 development. Funding for the project to the joint venture is expected to be split into vendor financing, export credit/bank finance and upstream partner equity.

**Exhibit 6: Financial summary**

	2017	2018	2019e	2020e	2021e
Year-end: 31 December, US\$000s	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
Total revenues	10,401	10,580	10,376	2,167	1,666
Cost of sales	(9,573)	(8,531)	(5,072)	(1,052)	(766)
Gross profit	828	2,049	5,304	1,114	900
SG&A (expenses)	(5,282)	(5,386)	(5,386)	(5,386)	(5,386)
Other income/(expense)	(3,422)	(5,014)	2,200	0	0
Exceptionals and adjustments	(1,830)	673	2,070	2,070	2,070
Reported EBIT	(9,706)	(7,678)	4,188	(2,202)	(2,416)
Finance income/(expense)	783	825	485	49	0
Other income/(expense)	(39)	(253)	(6,979)	(7,852)	(8,833)
Exceptionals and adjustments	0	0	0	0	0
Reported PBT	(8,962)	(7,106)	(2,306)	(10,004)	(11,249)
Income tax expense (includes exceptionals)	2,823	(25)	0	0	0
Reported net income	(6,139)	(7,131)	(2,306)	(10,004)	(11,249)
Basic average number of shares, m	457	457	457	457	457
Basic EPS (c)	(1.3)	(1.6)	(5.0)	(21.9)	(24.6)
Adjusted EBITDA	(2,403)	(4,383)	4,915	(3,665)	(4,031)
Adjusted EBIT	(13,349)	(12,319)	(679)	(4,878)	(4,941)
Adjusted PBT	(12,605)	(11,747)	(7,173)	(12,681)	(13,774)
Adjusted EPS (c)	(5)	(1)	(7)	(19)	(21)
Adjusted diluted EPS (c)	(5)	(1)	(7)	(19)	(21)
<b>BALANCE SHEET</b>					
Property, plant and equipment	11,585	11,836	26,086	28,883	139,517
Goodwill	0	0	0	0	0
Intangible assets	432,147	447,035	448,988	448,684	448,684
Other non-current assets	10,789	10,308	15,308	15,308	15,308
Total non-current assets	454,521	469,179	490,382	492,875	603,510
Cash and equivalents	50,729	40,426	20,000	20,000	20,000
Inventories	1,621	1,779	1,779	1,779	1,779
Trade and other receivables	16,840	9,510	15,000	15,000	15,000
Other current assets	4,354	568	568	568	568
Total current assets	73,544	52,283	37,347	37,347	37,347
Non-current loans and borrowings	0	0	2,215	5,383	116,956
Other non-current liabilities	85,245	90,971	97,950	105,802	114,635
Total non-current liabilities	85,245	90,971	100,166	111,185	231,591
Trade and other payables	12,772	15,148	13,048	13,048	13,048
Current loans and borrowings	0	0	0	0	0
Other current liabilities	9,450	0	0	0	0
Total current liabilities	22,222	15,148	13,048	13,048	13,048
Equity attributable to company	420,598	415,343	414,515	405,989	396,218
Non-controlling interest	0	0	0	0	0
<b>CASH FLOW STATEMENT</b>					
Profit for the year	(8,962)	(7,106)	(2,306)	(10,004)	(11,249)
Taxation expenses	0	0	0	0	0
Net finance expenses	(743)	(572)	6,494	7,802	8,833
Depreciation and amortisation	5,687	4,111	2,797	607	455
Share based payments	864	1,478	1,478	1,478	1,478
Other adjustments (impairments)	5,652	1,628	0	0	0
Movements in working capital	(868)	5,891	(7,590)	0	0
Interest paid / received	0	0	0	0	0
Income taxes paid	0	0	0	0	0
Cash from operations (CFO)	1,630	5,430	873	(117)	(483)
Capex*	(26,817)	(15,784)	(19,000)	(15,000)	(111,090)
Acquisitions & disposals net	(6,266)	(658)	0	11,900	0
Other investing activities	521	722	5,485	49	0
Cash used in investing activities (CFIA)	(32,562)	(15,720)	(13,515)	(3,051)	(111,090)
Net proceeds from issue of shares	0	0	0	0	0
Movements in debt	0	0	2,215	3,167	111,573
Other financing activities (includes rig settlement)	(13)	18	0	0	0
Cash from financing activities (CFF)	(13)	18	2,215	3,167	111,573
Increase/(decrease) in cash	(30,945)	(10,272)	(10,426)	0	0
Currency translation differences and other	655	(31)	0	0	0
Cash at end of period	20,729	10,426	0	0	0
Net (debt)/cash including term deposits	50,729	40,426	17,785	14,617	(96,956)
Movement in net (debt) cash over period	(30,290)	(10,303)	(22,641)	(3,167)	(111,573)

Source: Rockhopper Exploration, Edison Investment Research. Note: \*Assumes capex ahead of Sea Lion Phase 1 first oil funded by Premier and Navitas interest-free loan from 1 January 2020.

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