

Monday, November 18, 2013

RH Petrogas (RHP SP)

Oil Discovery At Zircon-1 Exploration Well, But Could Be Non-Commercial

Following the announcement of an oil discovery on 25 September, RHP announced that it had failed to recover hydrocarbons at its Zircon-1 exploration well. We understand that there could be a chance that it would be non-commercial, resulting in a write-off of US\$5m-6m later on. Nonetheless, we remain excited with near-term catalysts and re-iterate our BUY recommendation. Target price: S\$1.60.

What's New

- **A final update on Zircon-1 exploration well.** Following the discovery of oil (announced on 25 September) at RHP's Zircon-1 exploration well, RHP announced that it had failed to recover any hydrocarbons during the drilling exercise. The well will be plugged and abandoned in accordance to the drilling programme, while RHP conducts post-mortem analysis on the well to further evaluate the Zircon structure.
- **Drilling rig redeployed to appraise an earlier discovery.** The Bohai-8 drilling rig, which was used to drill the Zircon-1 exploration well will be moved to a new drill site. The drill site would be an earlier discovery (Koi-1) which tested 980 barrels of oil per day (bopd) and 2.7 million cubic feet per day (mmscfd) of gas per day in year 2000.

Stock Impact

- **What does the announcement mean?** RHP successfully discovered oil at the Zircon-1 exploration well but it could not be recovered during the drilling. This means that there is a chance of the oil discovery being non-commercial.
- **This could be due to many possibilities** such as low pressure at the reservoir, oil being too viscous or too heavy etc. While this could be negative at a first glance, it does not mean that this is the end of the story for RHP, as solutions, such as steam flooding or enhanced oil recovery, could be implemented to successfully recover these hydrocarbons. We will need to wait for RHP's post-mortem analysis to determine if the oil discovery is commercially viable.

Key Financials

Year to 31 Dec (US\$m)	2011	2012	2013F	2014F	2015F
Net turnover	89	86	87	135	176
EBITDA	34	29	21	38	62
Operating profit	21	18	11	23	45
Net profit (rep./act.)	3	6	(12)	7	15
Net profit (adj.)	3	6	(12)	7	15
EPS (US\$ cent)	0.6	1.2	(2.0)	0.9	2.0
PE (x)	81.0	44.2	n.m.	55.6	26.1
P/B (x)	2.2	1.5	1.9	2.2	2.0
EV/EBITDA (x)	11.9	13.8	19.0	10.6	6.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net margin (%)	3.3	7.1	(13.9)	5.1	8.3
Net debt/(cash) to equity (%)	51.3	7.6	12.9	23.7	37.5
Interest cover (x)	19.1	13.2	10.1	10.6	12.2
ROE (%)	2.7	4.2	(6.9)	4.0	8.0
Consensus net profit	-	-	(12)	8	18
UOBKH/Consensus (x)	-	-	1.05	0.82	0.80

Source: RH Petrogas, Bloomberg, UOB Kay Hian

BUY
(Maintained)

Company Update

Share Price S\$0.65
Target Price S\$1.60
Upside +145.5%

Company Description

RH Petrogas is an upstream oil & gas company that has exploration, development and production assets

Stock Data

GICS sector	Energy
Bloomberg ticker:	RHP SP
Shares issued (m):	733.3
Market cap (SGDm):	476.6
Market cap (US\$m):	381.7
3-mth avg daily t'over (US\$m):	3.5

Price Performance (%)

52-week high/low	SGD0.920/SGD0.420			
1mth	3mth	6mth	1yr	YTD
(19.8)	32.7	30.0	56.6	23.8

Major Shareholders

	%
Woodsville International	29.0
Smartphone Investments	18.2
RH Capital	17.5

FY13 NAV/Share (USD)	0.27
FY13 Net Debt/Share (USD)	0.04

Price Chart



Source: Bloomberg

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- **Negative surprise on Zircon but positive on the oil discovery.** While the announcement is a negative surprise to us as it may result in a write-off if deemed non-commercial, we are also excited on the successful oil discovery as it is a testament to management's expertise, which is crucial to enhance shareholders' returns.
- **In a best-case scenario,** management would be able to extract the oil using the methods highlighted earlier, but it may result in lower profitability given that additional recovery methods would incur additional costs. From a valuation perspective, we would enhance our target price by S\$0.045 if the project is commercially viable as we would attach a 50% risking factor (from 15%) to the resources at Zircon as it is upgraded from prospective resources to contingent resources (2C).
- **In a worst-case scenario,** it may result in a write-off of some US\$5m-6m. We will thereby reduce our target price by S\$0.03 if we were to remove the value of the oil at Zircon, worth S\$20.5m in our NPV and risking model.
- **M&A in the pipeline.** RHP also hosted a conference call on Friday, attended by some 10-12 fund managers. While most of the events highlighted by management had already been mentioned in our previous report last week, we gathered from the conference call that management may be looking to acquire two additional production assets next year (one in 1H14 and one in 2H14). The acquisition, coupled with other production wells put in place, would enhance its cash-flow generating capabilities.

Earnings Revision/Risk

- **No revisions.** We make no changes to our earnings forecast for now pending the results of the post-mortem analysis. In a worst-case scenario, there could be a chance that RHP may write off the costs related to the exploration well if the oil find is considered non-commercial. This may result in a write-off of some US\$5m-6m based RHP's 33% stake in the PSC.

Valuation/Recommendation

- **Maintain BUY, target price of S\$1.60 is based on our NPV and risking model.** We retain our BUY call on RHP as oil discoveries in the near term and the final approval for the development of its China oilfield could re-rate the stock. Our target price of S\$1.60 is based on the NPV of the company's current production/near-production fields, plus risked estimates of its 2C resources and prospective resources, less net debt adjusted for its committed capex and new funds raised from its recent private placement exercise.
- **Downside to our target price at S\$1.00.** Assuming if investors attach no value to its near-production asset in China, Fuyu 1, we think the downside for RHP's share price to our target price is capped at S\$1.00.
- **In a blue-sky scenario, RHP could be worth S\$2.02 in 2014 and S\$3.21 in 2015.** Based on our alternative valuation method for RHP in 2014 and 2015, by valuing RHP's assets individually, RHP could be worth S\$2.02 in 2014 and S\$3.21 in 2015. This is because its share price would likely re-rate if its exploration and development initiatives are successful.

Share Price Catalyst

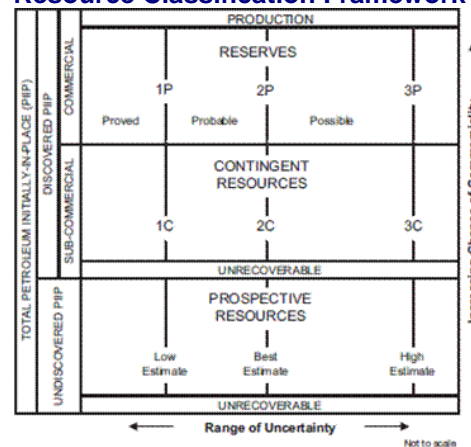
- Successful discovery of O&G in its exploration assets.
- Final approval obtained for its overall development plan for its oilfield in China, Fuyu 1.
- Higher-than-expected oil prices, resulting in additional revenues for RHP.

RHP's Valuation Table (NPV and risking model)

	Value (\$m)
Production/Near-production	
Basin PSC, Indonesia	198.4
Island PSC, Indonesia	38.9
Fuyu-1 Shallow Oil	467.9
Sub-total	705.2
Development/Pre-Development	
Basin PSC, Indonesia - North Klalin	49.9
Island PSC, Indonesia - TBC	34.1
Island PSC, Indonesia - Koi	24.4
Island PSC, Indonesia - North Sele	27.8
Island PSC, Indonesia - Zircon	20.5
Sub-total	156.6
Exploration	
Basin PSC, Indonesia	137.7
Island PSC, Indonesia	120.0
Fuyu-1 Deep Gas	10.1
West Belida PSC, Indonesia	1.5
SK331 PSC, Malaysia	33.8
Sub-total	303.1
Total Value (\$m)	1,165.0
Net Debt (\$m)	(39.8)
Minus Committed Capex (\$m)	(28.4)
Plus Net Proceeds from Placement (\$m)	70.2
Total Equity Value (\$m)	1,167.0
Existing Shares Outstanding (m)	731.3
NAV per Share (\$)	1.60

Source: UOB Kay Hian

Resource Classification Framework



Source: Society of Petroleum Engineers

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Profit & Loss

Year to 31 Dec (US\$m)	2012	2013F	2014F	2015F
Net turnover	86	87	135	176
EBITDA	29	21	38	62
Deprec. & amort.	11	10	15	18
EBIT	18	11	23	45
Total other non-operating income	0	0	0	0
Associate contributions	0	0	0	0
Net interest income/(expense)	(2)	(2)	(4)	(5)
Pre-tax profit	16	(3)	20	39
Tax	(10)	(9)	(13)	(25)
Minorities	0	0	0	0
Preferred dividends	0	0	0	0
Net profit	6	(12)	7	15
Net profit (adj.)	6	(12)	7	15

Balance Sheet

Year to 31 Dec (US\$m)	2012	2013F	2014F	2015F
Fixed assets	69	126	160	191
Other LT assets	206	206	206	206
Cash/ST investment	29	20	31	31
Other current assets	16	18	24	31
Total assets	319	371	421	460
ST debt	5	5	35	65
Other current liabilities	53	51	77	100
LT debt	37	37	37	37
Other LT liabilities	43	109	96	68
Shareholders' equity	181	169	176	190
Minority interest	0	0	0	0
Total liabilities & equity	319	371	421	460

Cash Flow

Year to 31 Dec (US\$m)	2012	2013F	2014F	2015F
Operating	19	(5)	39	39
Pre-tax profit	16	(3)	20	39
Tax	(8)	(9)	(13)	(25)
Deprec. & amort.	11	10	15	18
Associates	0	0	0	0
Working capital changes	(6)	(1)	26	22
Non-cash items	0	0	0	0
Other operating cashflows	5	(2)	(9)	(15)
Investing	(29)	(68)	(49)	(49)
Capex (growth)	(28)	(68)	(49)	(49)
Capex (maintenance)	0	0	0	0
Investments	0	0	0	0
Proceeds from sale of assets	0	0	0	0
Others	(1)	0	0	0
Financing	14	73	30	20
Dividend payments	0	0	0	0
Issue of shares	0	73	0	0
Proceeds from borrowings	44	0	30	20
Loan repayment	(29)	0	0	0
Others/interest paid	(2)	0	0	0
Net cash inflow (outflow)	4	1	20	10
Beginning cash & cash equivalent	21	25	20	31
Changes due to forex impact	4	(5)	(10)	(10)
Ending cash & cash equivalent	29	20	31	31

Key Metrics

Year to 31 Dec (%)	2012	2013F	2014F	2015F
Profitability				
EBITDA margin	33.9	24.6	28.3	35.3
Pre-tax margin	18.8	(3.5)	14.5	22.4
Net margin	7.1	(13.9)	5.1	8.3
ROA	2.0	(3.5)	1.7	3.3
ROE	4.2	(6.9)	4.0	8.0
Growth				
Turnover	(3.4)	0.1	56.1	30.4
EBITDA	(14.0)	(27.3)	79.4	63.0
Pre-tax profit	(13.9)	(118.7)	n.a.	101.8
Net profit	108.2	(297.1)	n.a.	113.4
Net profit (adj.)	108.2	(297.1)	n.a.	113.4
EPS	83.5	(265.8)	n.a.	113.4
Leverage				
Debt to total capital	18.9	20.0	29.1	34.9
Debt to equity	23.4	25.0	41.1	53.7
Net debt/(cash) to equity	7.6	12.9	23.7	37.5
Interest cover (x)	13.2	10.1	10.6	12.2

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MCI (P) 122/03/2013
RCB Regn. No. 198700235E