

# High Peak Royalties

Depressed oil market good for acquisitions

Update on acquisitions

Oil & gas

High Peak Royalties (HPR) is a globally-focused royalty company with 23 oil and gas projects, and an investment in another royalty company. It has taken advantage of recent depressed market conditions to make two acquisitions. HPR is actively reviewing a range of additional opportunities, which extend to commodities other than hydrocarbons. Its higher profile since re-listing has provided increasing opportunities for review.

Year end	Revenue (A\$m)	PBT* (A\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
06/13	0.3	(0.8)	(0.6)	0.0	N/A	N/A
06/14	0.3	(1.2)	(2.6)	0.0	N/A	N/A
06/15e	0.5	(1.0)	(0.6)	0.0	N/A	N/A
06/16e	0.9	(0.3)	(0.2)	0.0	N/A	N/A

Note: \*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

## Global reach to review royalty opportunities

The low oil price environment has proven to be a positive for HPR and has led to a significant increase in royalty opportunities. This is partly due to the reduced equity and debt finance available to oil and gas companies. Management is assisted in royalty identification and selection by an experienced international board, which, in addition to board responsibilities, operates as investment sub-committees. This has allowed HPR to operate globally and enabled it to diversify its search. The company is now actively reviewing gold opportunities and opportunities in other commodities in addition to oil and gas.

## Growth from acquisitions and project advances

HPR recently completed two acquisitions comprising gas royalties in Texas and a 19.99% strategic interest in another royalty company, Royenco Resources (ASX:RCO). The Texas royalties apply to 43 active oil and natural gas wells over three different basins with different operators. RCO has a 1% interest in the Weeks Petroleum royalty, which has a 2.5% overriding royalty across 19 oil and gas permits in the globally significant Bass Strait operated by ExxonMobil. These permits currently supply 40% of east coast of Australia gas demand and its gas may be subject to upwards price pressure due to rising LNG demand. HPR is also exposed to LNG through its PL 171 and ATP574P permits in the Surat Basin, which will supply the North processing hub intended to supply QCLNG Train 2, scheduled for completion in late 2015.

## Valuation: Well above the share price

Our main valuation method for HPR's royalty streams is an NPV<sub>10</sub> calculation, using our oil price forecasts. Our risked exploration NAV (RENAV) is A\$0.21/share (after tax). This valuation is expected to increase by approximately A\$0.02 pa as new projects advance to the cash-flow stage. Following the recent Texas and RCO acquisitions, HPR reported a cash balance of A\$2.67m at 31 March 2015. It has a focus on cash preservation so that the company remains well positioned to exploit royalty opportunities.

20 May 2015

Price **A\$0.10**

Market cap **A\$15m**

US\$0.77/A\$

Net cash (A\$m) at 31 Mar 2015 2.67

Shares in issue 166.8m

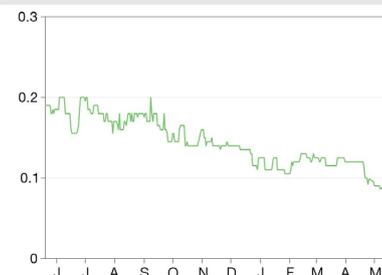
Free float 58%

Code HPR

Primary exchange ASX

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs (20.8) (24.0) (52.5)

Rel (local) (17.6) (20.6) (54.4)

52-week high/low A\$0.20 A\$0.09

## Business description

High Peak Royalties (HPR) was established to generate income from royalties. The focus until recently was on oil and gas, but the company is now reviewing other areas such as the mining sector. It is intended that growth will be driven by project advancements on existing permits supplemented by acquisitions.

## Next event

June activities update July 2015

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## Favourable market environment for royalty acquisitions

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HPR has experienced a significant increase in the number of royalty acquisition opportunities. This can be attributed to the recent substantial fall in the oil price and reduced availability of equity and debt. Some US oil and gas companies have already started to seek bankruptcy protection. Merger and acquisition and private equity activity in the sector have also increased.

Since the company relisted in May 2014, HPR has reviewed over 50 potential transactions with a total value of A\$290m. It has conducted desktop due diligence on 29 opportunities (total deal value around A\$190m). While market conditions have increased the number of royalty opportunities, HPR believes its higher profile among sellers/financing prospects has also helped.

HPR has progressed to non-binding bid documentation on eight assets and closed on two acquisitions – the Texas oil and gas royalties acquired from The Dillon Fund and the 19.99% stake in Royalco Resources. The Texas royalties and the Royalco investment are described in more detail below.

The company still has the financial capacity for further acquisitions. After the relisting, HPR had a cash balance of A\$6.1m. At the 31 March 2015 balance date, the company still had a cash balance of almost A\$2.7m.

## Acquisition of royalty interests in Texas

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HPR acquired royalties, primarily on natural gas production, in three Texan counties effective 1 January 2015. The royalty interests apply to 43 active wells spread over three different basins. Each basin has a different operator. HPR began to receive cash flow from the royalty interests from the start of calendar 2015. The interests were acquired from The Dillon Fund, a non-profit foundation based in New York.

The purchase consideration was US\$350,000.

## Acquisition strategy – US exposure and gas diversification

The acquisition represents the first acquisition of royalties by HPR in the US. HPR has a director based in Dallas who is well placed to review and assess royalty opportunities. In this regard, HPR has incorporated a US subsidiary for the acquisition of these royalty interests.

Royalty income is derived mainly from natural gas production at US prices. This provides portfolio diversification as US prices are not correlated with domestic gas prices on the east coast of Australia.

## Basin/operator exposure

- **Harrison County (East Texas Basin):** The wells are operated by Sabine Oil and Gas (OTCMKTS:SOGC). Sabine recently merged with Forest Oil. Its largest shareholder is First Reserve, an energy-focused private equity firm.
- **Midland County (Permian Basin):** Wells operated by Pioneer Natural Resources (NYSE:PXD).
- **Willacy County (Texas Gulf Coast Basin):** Wells operated by Wagner Oil Company. Wagner is a private oil and gas acquisition, exploration and development company in Fort Worth. It operates mainly in Texas and Louisiana.

## Royalties

There are both overriding royalty interests and non-participating royalty interests. The royalty rates vary from 0.2% to 0.4%.

- **Overriding royalty interests:** Terms are dependent on the term of the underlying leases, which is typically held by production.
- **Non-participating royalty interests:** Terms are normally perpetual.

## Acquisition of a strategic stake in Royalco Resources

In February 2015, HPR acquired a strategic 19.99% shareholding in ASX-listed Royalco Resources (RCO). Royalco holds a collection of royalty interests across Australia and overseas. The total consideration was A\$2.1m. The RCO holding of 10,540,000 shares was purchased from LSE-listed royalty company Anglo Pacific Group (LON:APF) at A\$0.20/share.

During the March quarter, 2015, RCO declared a dividend of A\$0.05 per share (fully franked). HPR subsequently received a dividend payment of A\$52,700.00.

RCO's royalty interests are tabulated in Exhibit 1.

**Exhibit 1: Royalco royalty interests**

Project	Operator	Royalty	Commodity
Weeks Petroleum	ExxonMobil	1% of 2.5%	Oil and gas
Reefton – Blackwater	Oceana Gold	1-3% of ORR	Gold
Bowdens	Kingsgate Resources	1-2% of NSR	Silver
Sam's Creek	MOD Resources	1% ORR	Gold
Mt Garnet	Snow Peak/CSD JV	3% NSR	Zinc, lead, silver
Stanton	Private	1% NSR	Nickel, cobalt
Red Dam	Private	1.5% ORR	Gold, silver
LFB	Regis Resources	3% NSR	Gold, copper
Uganda	Private	1.55% NSR	Gold
Mt Lyndhurst	Syrah Resources	1.5% NSR	Copper

Source: Royalco Resources Limited

## Weeks Petroleum royalty

Currently, RCO is only receiving consistent royalties from its 1% interest in the Weeks Petroleum royalty. This is a 2.5% overriding royalty covering all production from the Bass Strait fields in the Gippsland Basin jointly owned by ExxonMobil (operator) and BHP Billiton.

Effectively, RCO has the equivalent of a 0.025% overriding royalty over all hydrocarbon production from the Bass Strait fields. Income from the interest has averaged A\$0.75-0.80m over the past three years.

## Other Royalco royalties

Most of RCO's other royalty interests represent early-stage exploration projects. However, there are two projects that are more advanced and offer the potential for development in the medium term:

- **Reefton-Blackwater – Oceana Gold (ASX:OGL):** Areas of the Reefton project outside the Globe Progress Mining Lease such as Blackwater are subject to royalties payable to RCO. The Reefton mine is to go on care and maintenance at the end of this year. A scoping study was carried out for the Blackwater project in 2014. In an update report on 8 April 2015, OGL stated that it would evaluate different mining options in 2015 to reduce the project risk. It indicated that the project could be brought into production at a relatively low cost.
- **Bowdens - Kingsgate Consolidated (ASX:KCN):** in its March Quarter 2015 Activities Report, KCN said it was continuing to focus on studies required for the Environmental Impact

Statement (EIS). In 2014, KCN applied to the NSW Department of Planning and Infrastructure to have the Director-General's Requirements (DGR) for Bowdens reissued for another two years. These prescribe a comprehensive range of assessments spanning environmental, socio-economic and regional impact that mining companies must satisfy to lodge an EIS and ultimately have it approved to begin mining operations.

## Diversification of royalty streams

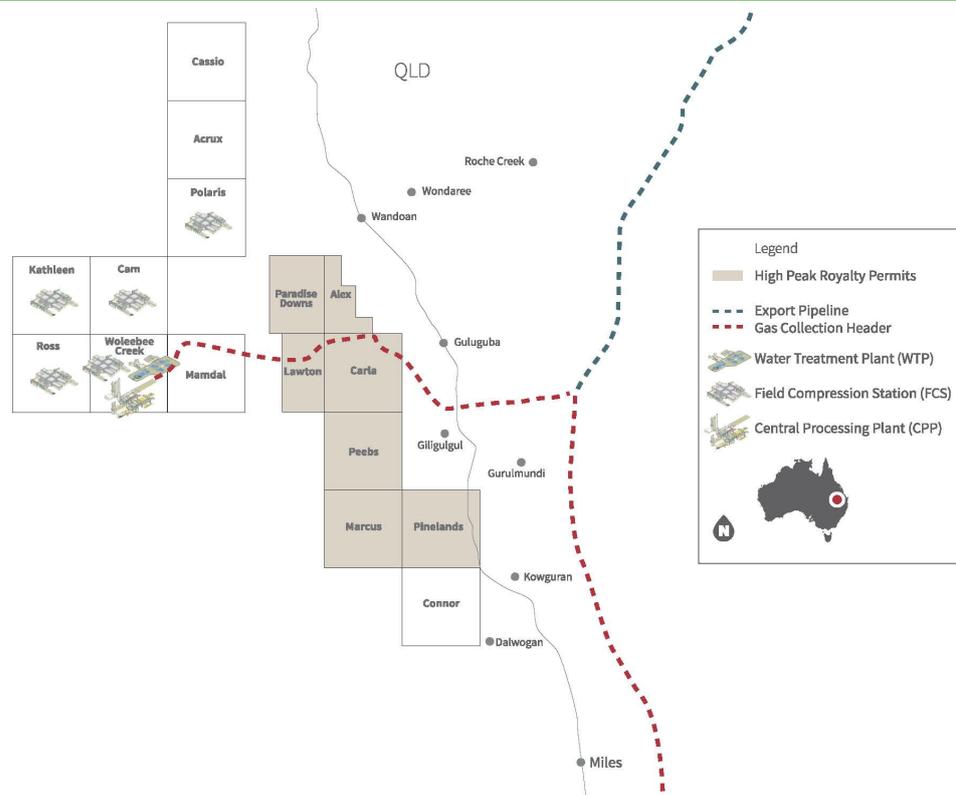
HPR indicated earlier that it was seeking diversification of royalty income.

- **Gold:** The company has been very active reviewing gold opportunities. It has conducted due diligence on seven opportunities with a total value of A\$39m. It has progressed to bid documentation on three assets.
- **Other commodities:** HPR has also investigated royalty opportunities in other areas such as copper, iron ore, mineral sands, tungsten, silver, electricity (geothermal and wind) and uranium.

## QCLNG Surat Basin – a new royalty stream for HPR

HPR has a 2.5% ORRI over Surat Basin PL171 and ATP574P. These are contiguous permit areas (total area 407km<sup>2</sup>), with both operated by QCLNG (former QGC/BG). Royal Dutch Shell (LON:RDSB) has recently announced an agreed takeover of BG Group. PL171 and ATP574P are in close proximity to the Woleebee Creek hub in the North region. They will be one of its gas suppliers. The Woleebee Creek hub includes a central processing plant (CPP), water treatment plant (WTP) and five field compression stations (FCSs). This hub will be commissioned before Train 2 start-up.

**Exhibit 2: High Peak royalty permits, QCLNG Woleebee Creek hub and gas pipelines**



Source: High Peak Royalties

The QCLNG plant on Curtis Island is expected to reach plateau production of 8Mtpa by mid-2016, resulting in up to 120 LNG shipments per year. It has two LNG trains.

- **Train 1:** Loading of the first export cargo began in December 2014. Train 1 is expected to move to commercial status in Q215.
- **Train 2:** Construction and commissioning of Train 2 is scheduled for completion in Q315.
- **South region and Central region processing hubs:** These will supply Train 1.
- **North region processing hub:** This will assist in meeting the additional demand from Train 2.

## Valuation

HPR provides exposure to royalty agreements over 24 oil and gas projects, 23 directly plus the Weeks Petroleum royalty indirectly through the recently acquired 19.99% interest in RCO. HPR is currently receiving royalty payments from seven different oil and gas entities plus the dividend stream from RCO. Payments from the QCLNG related PL171 and ATP574P agreements could potentially commence in 2017.

Royalty payments are projected to increase in the future associated with development projects coming to fruition and oil and gas discoveries on exploration permits.

Our production and development Net Asset Value (NAV) is A\$0.19/share (after tax), while a risked exploration NAV (RENAV) is A\$0.21/share (after tax). A pre-tax RENAV is A\$0.26/share.

### Valuation method

We have conducted an NPV<sub>10</sub> valuation on the projected cash flow for each royalty with a risk weighting varying from 100% for an existing producer to a risk weighting as low as 10% for an explorer. The risk weighting depends on how advanced the exploration is and confidence in how the project is progressing. We consider the NPV method an appropriate methodology as it is able to incorporate variables such as price, volume, operating and capital costs and time schedule.

- We have used an NPV discount rate of 10% on royalty cash flow.
- We use our oil price forecasts in our valuations, as in Exhibit 3. Oil prices are escalated at 2.5% pa from 2020. Costs are escalated by 2.5% pa. We use a long-term A\$/US\$ exchange rate of 0.82.
- In our oil and gas coverage, we do not include value in our RENAV for exploration prospects that are not funded or outside an 18-month timeline.
- Our export gas prices are based on an LNG net-back price, derived from the Brent price. The LNG net-back price uses the Japanese Custom-cleared Crude (or Japanese Crude Cocktail) (JCC) price at a 1% discount to Brent, a slope of 0.14, marketing margins and LNG fuel usage of 7.5% and 9% respectively plus a plant, pipeline and processing tariff of A\$5.5/GJ.

**Exhibit 3: Edison oil price forecasts – escalated at 2.5% pa from 2019 onwards**

Year	2015	2016e	2017e	2018e	2019e	2020e
Brent (US\$/bbl)	58.5	72.5	79.2	83.7	88.3	90.5

Source: Edison Investment Research

Our valuations of HPR's royalties are in Exhibit 4.

**Exhibit 4: Valuation summary**

	Area	Operator		Risk factor	ORRI (%)	Valuation (A\$000)	
						Pre-tax	After-tax
<b>Producing</b>							
Longtom (VIC/L29, VIC/P54)	Gippsland Basin	Seven Group Holdings	Oil, condensate	100%	0.30%	907	635
Tintaburra Oil Field (ATP 299P)	Cooper/Eromanga	Santos	Oil	100%	3.6/4.0%*	2,241	1,569
Peat Gas Field (PL101)	Bowen Basin	Origin Energy	Gas	100%	2.13%	2,581	1,807
Surprise Oil Field (PL6)	Amadeus Basin	Central Petroleum	Oil	100%	1.0%	497	348
Texas	E Texas, Permian, T Gulf	Sabine, Pioneer Natural, Wagner	Gas	100%	0.2-0.4%	398	279
<b>Development</b>							
Surat Basin CSG Project (PL171)	Surat Basin	QGC/BG Group	Gas	65%	2.5%	11,233	7,863
Surat Basin CSG Project (ATP574)	Surat Basin	QGC/BG Group	Gas	65%	2.5%	17,306	12,115
<b>Investment</b>							
Royalco (19.9%)						2,161	2,161
Tax losses							3,490
Corporate costs						-2,100	-1,470
Net cash (31 March 2015)						2,665	2,665
<b>Subtotal</b>						<b>37,890</b>	<b>31,461</b>
<b>NAV Production &amp; development (A\$/share)</b>						<b>0.23</b>	<b>0.19</b>
<b>Exploration</b>							
Greater Poseidon LNG Project (WA-315-P)	Browse Basin	ConocoPhillips	Gas	25%	0.1031%	3,572	2,501
Petroleum Blocks EP 112, EP 115NM, EP 125	Amadeus Basin	Santos	Oil	15%	1.0%	856	599
WA 482P (book value)	Northern Camarvon	Apache Corporation	Oil	100%	0.20%	700	700
<b>Subtotal</b>						<b>5,128</b>	<b>3,800</b>
<b>Total</b>						<b>43,018</b>	<b>35,261</b>
<b>RENAV Valuation (A\$/share)</b>						<b>0.26</b>	<b>0.21</b>

Source: High Peak Royalties, Edison Investment Research. Note: \*NPI royalty.

We do not include any exploration where a well is not planned in the next 18 months or not funded. An asset that falls under this categorisation for HPR is below. This asset could provide value in the longer term and will be included in the RENAV valuation when appropriate.

**Exhibit 5: Longer-term value potential**

				Risk factor	ORRI (%)	Valuation (A\$000)	
						Pre-tax	After-tax
Longer-term exploration value potential							
PEL 512 (book value)	Cooper Basin	Discovery Energy	Oil	100%	1.30%	100	100

Source: Edison Investment Research

**Exhibit 6: Financial summary**

	A\$'000s	2013	2014	2015e	2016e
Year-end 30 June		IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
Revenue		258	316	470	905
Cost of Sales		(920)	(1,353)	(1,505)	(1,253)
Gross Profit		(662)	(1,036)	(1,035)	(348)
EBITDA		(667)	(1,044)	(1,055)	(368)
Operating Profit (before amort. and except.)		(668)	(1,046)	(1,057)	(370)
Intangible Amortisation		(260)	(294)	(289)	(300)
Exceptionals		0	(1,187)	0	0
Share-based payments		0	0	0	0
Operating Profit		(928)	(2,527)	(1,346)	(670)
Net Interest		(106)	(172)	75	64
Profit Before Tax (norm)		(774)	(1,218)	(982)	(306)
Profit Before Tax (FRS 3)		(1,033)	(2,699)	(1,270)	(606)
Tax		0	0	0	0
Profit After Tax (norm)		(774)	(1,218)	(982)	(306)
Profit After Tax (FRS 3)		(1,033)	(2,699)	(1,270)	(606)
Minorities		0	0	0	0
Associated company income		0	0	0	0
Net income (norm)		(774)	(1,218)	(982)	(306)
Net income (FRS 3)		(1,033)	(2,699)	(1,270)	(606)
Average Number of Shares Outstanding (m)		124.8	47.5	166.8	166.8
EPS - normalised (c)		(0.6)	(2.6)	(0.6)	(0.2)
EPS - normalised and fully diluted (c)		(0.6)	(2.6)	(0.5)	(0.2)
EPS - (IFRS) (c)		(0.8)	(5.7)	(0.8)	(0.4)
Dividend per share (c)		0.0	0.0	0.0	0.0
Gross Margin (%)		N/A	N/A	N/A	N/A
EBITDA Margin (%)		N/A	N/A	N/A	N/A
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A
<b>BALANCE SHEET</b>					
Fixed Assets		12,208	14,020	16,141	15,839
Intangible Assets		11,388	10,781	11,720	11,420
Tangible Assets		820	3,239	2,321	2,319
Investments		0	0	2,100	2,100
Current Assets		1,155	6,949	2,846	2,542
Stocks		0	0	0	0
Debtors		25	228	112	112
Cash		1,130	6,718	2,731	2,428
Other		0	3	3	3
Current Liabilities		(612)	(894)	(337)	(337)
Creditors		(212)	(474)	(337)	(337)
Short term borrowings		(400)	(420)	0	0
Long Term Liabilities		(408)	(200)	(200)	(200)
Long term borrowings		(408)	0	0	0
Other long term liabilities		0	(200)	(200)	(200)
Net Assets		12,343	19,875	18,451	17,845
<b>CASH FLOW</b>					
Operating Cash Flow		(510)	(1,378)	(1,164)	(368)
Net Interest		(78)	13	132	64
Tax		0	0	0	0
Capex		0	0	0	0
Acquisitions/disposals		(403)	(95)	(2,534)	0
Equity financing, other		1,765	7,435	0	0
Dividends		0	0	0	0
Net Cash Flow		774	5,975	(3,567)	(304)
Opening net debt/(cash)		(367)	(323)	(6,298)	(2,731)
HP finance leases initiated		0	0	0	0
Other		(819)	0	0	0
Closing net debt/(cash)		(323)	(6,298)	(2,731)	(2,428)

Source: Edison Investment Research, High Peak Royalties accounts

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