

Analyst

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Authorisation

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Hartshead Resources NL (HHR)

Funding option de-risks development

Recommendation
Buy (unchanged)

Price
\$0.026
Valuation
\$0.09 (previously \$0.07)

Risk
Speculative
GICS Sector
Energy
Expected Return

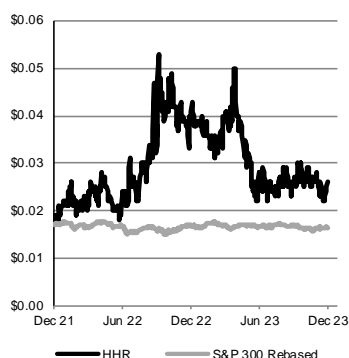
Capital growth	246%
Dividend yield	0%
Total expected return	246%

Company Data & Ratios

Enterprise value	\$38m
Market cap	\$73m
Issued capital	2,809m
Free float	78%
Avg. daily val. (52wk)	\$188,562
12 month price range	\$0.021-\$0.05

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.03	0.02	0.03
Absolute (%)	0.0	13.0	-21.2
Rel market (%)	-3.3	16.3	-17.9

Absolute Price


SOURCE: IRESS

Free carry option de-risks project capital requirements...

HHR has announced an agreement with joint venture partner RockRose Energy (unlisted), providing HHR the option to divest an additional 20% of the UK Southern Gas Basin Licence P2607 for an uncapped free carry to support the project's Phase 1 development. The P2607 licence is held 40% HHR and 60% RockRose; exercising the option would reduce HHR's interest to 20%. The agreement provides funding security for the project. In parallel, HHR will continue to evaluate alternative debt funding to support the retention of its 40% interest.

... and enables development to remain on track

The agreement enables the joint venture to proceed to FID and commence development in early 2024 for first gas from 2H 2025. P2607 Phase 1 (Anning & Somerville) has an estimated gross capital cost of £351m (~A\$670m) and will develop 2P Reserves of 302Bcf at initial rates of 140Mmscf/day (51 Bcf/year) tied-in to existing Shell infrastructure for sale into the UK gas market. We still think HHR's "Plan A" is to seek debt funding and retain a 40% interest. However, the agreement provides a funding backstop and more than 12 months to negotiate debt terms without delaying the project's development. The A\$800m in committed funding now arranged for the project provides look-through value materially higher than HHR's enterprise value.

Investment view – Speculative Buy, Valuation \$0.09/sh

We expect HHR equity to re-rate as the Phase 1 project is de-risked into development and financing is secured. The investment provides value leverage to UK and European gas markets which have recently experienced "energy crisis" pricing and are looking to diversify sources of energy supply. HHR's Southern Gas Basin portfolio could support subsequent phases of production and value growth. Our HHR valuation is primarily based on a risked discounted cash flow model of the Anning & Somerville fields with gas price assumptions consistent with the current UK NBP forward curve.

HHR is a project development company with prospective operations and cash flows only. Our Speculative risk rating recognises this higher risk and volatility of returns.

Earnings Forecast

Year ending 30 June	2023a	2024e	2025e	2026e
Sales (A\$m)	8	-	-	269
EBITDA (A\$m)	1	(2)	(2)	219
NPAT (reported) (A\$m)	1	(1)	(5)	161
NPAT (adjusted) (A\$m)	2	(1)	(5)	161
EPS (adjusted) (A¢ps)	0.1	(0.0)	(0.2)	5.7
EPS growth (%)	na	-160%	na	na
PER (x)	32.3x	-53.7x	-15.3x	0.5x
FCF Yield (%)	2%	-6%	-204%	214%
EV/EBITDA (x)	28.6x	-19.0x	-19.0x	0.2x
Dividend (A¢ps)	-	-	-	-
Yield (%)	0%	0%	0%	0%
Franking (%)	-	-	-	-
ROE (%)	7%	-4%	-14%	143%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Funding option de-risks development

Option to cover capex through further farm-down

HHR has announced an option agreement with joint venture partner RockRose Energy (unlisted) which provides security of funding for 100% of the UK Southern Gas Basin Licence P2607 project (HHR 40%, RockRose 60%). Under the agreement, HHR has the option to divest an additional 20% licence interest for an uncapped free carry of project development capital. HHR can exercise the option at the point that RockRose's initial carry for Phase 1 has been fully expended (expected by Q2 2025). Exercising the option would increase the total committed project funding to over A\$800m.

In parallel, HHR will continue negotiations with potential debt/offtake finance providers to support the retention of its 40% interest. The agreement also sees the Phase 1 cash bonus agreed as part of HHR's April 2023 farm out agreement (A\$41m) converted and increased to A\$55m in project free carry in the event that HHR retains its 40% interest, taking HHR's total free carry to A\$150m.

DE-RISKING FUNDING; ENSURING PROJECT REMAINS ON TRACK

We ultimately expect that HHR's "Plan A" is to arrange debt/offtake financing and retain a 40% interest in the project. However, there are key benefits from the recent agreement:

- **Phase 1 project fully funded:** The P2607 Phase 1 project is now fully funded with over A\$800m in total committed project funding.
- **Buying time for debt discussions:** HHR now has over 12 months to progress discussions with debt finance providers and avoid the sell-down (i.e. retain 40% of the project).
- **Potential for better debt terms with FID in place:** De-risking of project through FID and with fixed price development contracts in place should see more competitive debt terms for project financing, should HHR elect to retain a 40% interest in the project.
- **Project timeline remains on track:** The funding guarantee enables HHR and RockRose to take FID and commence project development in early 2024 for first gas from 2H 2025.
- **Look through value:** The RockRose A\$800m funding commitment implies a farm-in capital contribution of A\$320m for HHR's 40% contribution, materially higher than HHR's current enterprise value.

Timeline & value catalysts

- ✓ 2021 – Acquired 100% of Licence P2607 during the UK's 32nd Offshore Licensing Round.
- ✓ 2022 – Completion of Competent Persons Report for Anning & Somerville resulting in the conversion of 301.5Bcf to 2P Reserves.
- ✓ 2022 – Letter of no objection received from the North Sea Transition Authority (NSTA) for the Concept Select Report (CSR).
- ✓ March 2023 – Agreement with Shell (SHEL:LN, not rated) on key commercial terms for gas transportation and processing.
- ✓ April 2023 – Farm-out completed for the divestment of 60% of Licence P2607 to RockRose Energy.
- ✓ May 2023 – Completion of Anning & Somerville geophysical survey, a critical component of the Environmental Statement and understanding of seabed and pipeline route conditions.

- 1Q 2024 – Enter binding agreement with Shell for gas transportation and processing.
- 1Q 2024 – Finalisation of project capital costs, debt financing and FID.
- 1Q 2024 – Begin development of platforms and pipeline modifications for tie-in with Shell infrastructure.
- Mid-2025 – First gas production.

Ongoing – Gas Contingent Resources and Reserves updated.

Financials & valuation methodology

Risked, sum of the parts valuation: \$0.09/sh

Table 1 - Risked, sum of the parts valuation

	100% A\$m	HHR interest %	HHR Unrisked A\$m	Risk disc %	HHR Risked A\$m
Anning and Somerville - Total to HHR (Phase 1)	655		307	30%	215
Hodgkin & Lovelace (Phase 2)	302	40.0%	121	80%	24
Exploration		100.0%			12
Total projects			428		251
Corporate overhead assumption					-20
Enterprise value					231
Net debt (diluted)					-35
Equity value					266
Diluted shares on issue m					2,871
Equity value A\$/sh					0.09

SOURCE: BELL POTTER SECURITIES ESTIMATES

Changes to valuation: Capital raising overhang removed

We have maintained our assumption that HHR funds its share of capital expenditure with debt/offtake finance and retains a 40% interest in the project.

Under the April 2023 farm-out agreement and the updated agreement this week, HHR is free carried for around A\$150m project development capital. Assuming project capex of A\$800m (A\$320m net to HHR), we estimate that HHR will seek debt funding of around A\$170m. Noting the previous capital cost estimate was £351m (~A\$670m), and therefore the quantum of debt required may be lower.

In this update we have:

- Deferred commencement of development at P2607 Phase 1 to Q1 2024 (previously Q3 2023) and first gas to Q3 2025 (previously Q1 2025).
- Removed the assumption of a \$30m capital raise, and its associated dilution.
- Minor adjustments to our UK gas price outlook, in line with the forward curve.

The net result is an increase to our valuation to \$0.09/sh (previously \$0.07/sh).

Phase 1: Anning & Somerville development (40% HHR)

We have modelled Phase 1 with a production profile similar to the Concept Select Report Best Case scenario. Key parameters, CPR vs Bell Potter Securities modelled, are outlined in the following table.

RISK DISCOUNT: 30% TO ACCOUNT FOR PRE-FID STAGE OF DEVELOPMENT

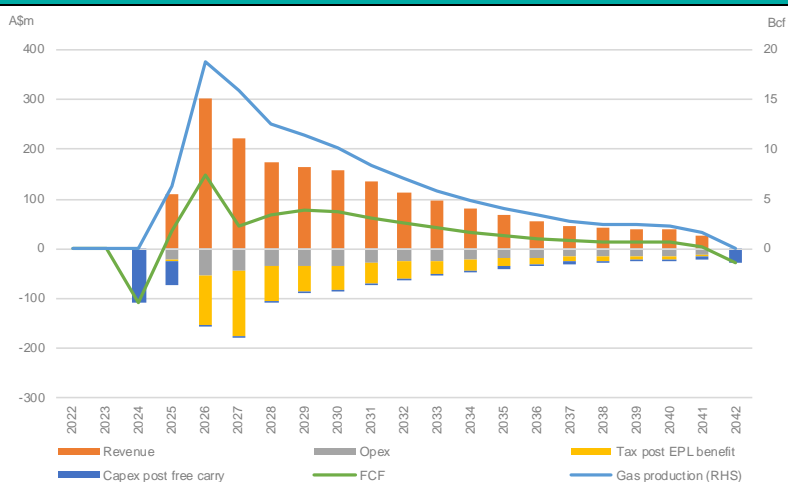
We have conservatively applied a 30% risk discount to the Phase 1 valuation to account for its pre-FID stage of development, consistent with other projects of this nature. The 8% real WACC combined with a 30% risk discount is equivalent to using a discount rate of around 14%.

Table 2 - Phase 1 modelled assumptions

Gross parameters	ERCE	Bell Potter assumption	Difference %
2C Resource	301.5 Bcf	301.5 Bcf	-
Initial capex	£351m	£421m	20%
First production	Late 2024	Mid-2025	6-month delay
Maximum production rate	130MMscfd	130MMscfd	-
Annual direct opex (average, real)	£11.0m	£11.0m	-
NPV10% (Best case, gross)	£514m	-	-

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Figure 1 - Phase 1 field production & cash flow summary (real, net to HHR)



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Phase 2: Hodgkin & Lovelace (40% HHR): 139 Bcf 2C Resource

The Hodgkin & Lovelace fields contain gross 139 Bcf of 2C Contingent Resources. Hodgkin’s 100 Bcf 2C Contingent Resource has had historic gas production of 26 Bcf, and therefore can be taken into production with a development well. The Lovelace field contains 39 Bcf of 2C Contingent Resources and has historical production of 18 Bcf.

We have adopted a heavily risked (80% discount), EV/Contingent Resource multiple approach, based on the 139 Bcf of 2C Resource.

ASX-listed energy sector

Table 3 - ASX-listed energy sector

Company Name	EV	Reserve & Resource (Mmboe)	Resource		Resource Multiples (A\$/boe)		Production rate* mmboe/p.a.	Production Multiples (A\$/boe) EV/prod.
			2C	2P + 2C	EV/2P	EV/2P+2C		
	A\$m	2P						
Woodside Energy Group (WDS)	60,945	3,640	8,661	12,301	16.7	4.95	185	329.4
Santos Limited (STO)	27,474	1,745	3,280	5,025	15.7	5.47	105	262.9
Beach Energy Limited (BPT)	3,627	255	195	450	14.2	8.06	20	186.0
Karoon Energy Ltd (KAR)	1,638	52	98	150	31.6	10.92	8	204.7
Strike Energy Limited (STX)	858	64	89	153	13.5	5.62	0	na
Cooper Energy Limited (COE)	397	36	48	85	10.9	4.69	4	103.2
Horizon Oil Limited (HZN)	198	5	7	12	40.4	16.76	1	148.5
Conrad Asia Energy Ltd (CRD)	194	0	68	68	na	2.84	0	na
Comet Ridge Limited (COI)	183	34	61	94	5.5	1.94	0	na
Talon Energy Ltd (TPD)	116	4	76	80	26.1	1.45	0	na
Carnarvon Petroleum Limited (CVN)	96	0	101	101	na	0.95	0	na
Galilee Energy Limited (GLL)	56	0	518	518	na	0.11	0	na
Central Petroleum Limited (CTP)	48	13	32	44	3.8	1.07	1	55.4
Armour Energy Limited (AJQ)	43	30	8	38	1.4	1.13	0	117.5
TMK Energy Limited (TMK)	40	0	148	148	na	0.27	0	na
Hartshead Resources (HHR)	38	21	10	31	1.8	1.22	0	na
Blue Energy Limited (BLU)	38	11	238	250	3.3	0.15	0	na
Vintage Energy Ltd (VEN)	30	9	3	12	3.5	2.54	0	na
Australis Oil & Gas Limited (ATS)	27	3	128	131	8.5	0.20	0	69.5
AXP Energy Limited (AXP)	7	7	212	219	1.0	0.03	1	10.3
Mean					12.4	3.5		149
Trimmed mean (25% excluded)					10.3	2.7		143
Median					9.7	1.7		133

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES
*CURRENT ANNUALIZED PRODUCTION RATE

Company summary

Company description

Hartshead Resources NL is focussed on the phased development of its offshore gas fields in the United Kingdom's Southern North Sea. The company is advancing its Phase 1 project Anning & Somerville, located within Licence P2607 where HHR holds a 40% interest. The Phase 1 gas fields contain historical production and a combined 302 Bcf of 2P Reserves. A final investment decision is expected in 1H 2024 for potential first gas production in mid-2025. Gas from Phase 1 is expected to tie-in to existing Shell-owned infrastructure for transportation into the UK gas market. Licence P2607 also encompasses HHR's earlier stage projects, including Phase 2 which contains 139Bcf of 2C Contingent Resources together with other exploration potential.

Investment view: Speculative Buy, Valuation \$0.09/sh

We expect HHR equity to re-rate as the Phase 1 project is de-risked into development and financing is secured. The investment provides value leverage to UK and European gas markets which have recently experienced "energy crisis" pricing and are looking to diversify sources of energy supply. HHR's Southern Gas Basin portfolio could support subsequent phases of production and value growth. Our HHR valuation is primarily based on a risked discounted cash flow model of the Anning & Somerville fields with gas price assumptions consistent with the current UK NBP forward curve.

HHR is a project development company with prospective operations and cash flows only. Our Speculative risk rating recognises this higher risk and volatility of returns.

Investment risks

Risks

Risk to energy sector equities include, but are not limited to:

- **Commodity price and exchange rate fluctuations.** The future earnings and valuations of exploration, development and operating energy and industrial development assets and companies are subject to fluctuations in underlying commodity prices (energy and other) and foreign currency exchange rates.
- **Infrastructure access.** Energy projects are reliant upon access to processing/treatment and pipeline infrastructure. Access to infrastructure is often subject to contractual agreements, permits and capacity allocations. Agreements are typically long-term in nature. Infrastructure can be subject to outages as a result of weather events or the actions of third party providers.
- **Operating and capital cost fluctuations.** Markets for exploration, development and costs of goods sold can fluctuate and cause significant differences between planned and actual operating and capital costs. Key operating costs are linked to energy, building/construction materials and labour markets. Energy companies are also exposed to costs associated with future rehabilitation.
- **Reserve and Resource risks.** Future earnings forecasts and valuations rely on accuracy of Reserve estimation, the ability to extract the underlying Reserve and the potential for Reserve life extensions.
- **Sovereign risks.** Energy companies' assets are subject to the sovereign risk of the country and state of location and may also be exposed to the sovereign risks of major offtake customers.
- **Regulatory changes.** Changes to the regulation of infrastructure, taxation, carbon abatement and environmental management (among other things) can impact the earnings and valuations of energy companies.
- **Environmental risks.** Energy companies are exposed to risks associated with environmental degradation as a result of their exploration and production processes. Fossil fuel producers may be partially exposed to the environmental risks of end markets including the electricity generation sector.
- **Operating and development risks.** Energy companies' assets are subject to risks associated with their operation and development. Development assets can be subject to approvals timelines or weather events, causing delays to commissioning and commercial production.
- **Occupational health and safety (OH&S) risks.** Energy and industrial development companies are exposed to OH&S risks.
- **Funding and capital management risks.** Funding and capital management risks can include access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments and managing debt repayments.
- **Merger/acquisition risks.** Risks associated with value transferred during merger and acquisition activity.
- **Impact of pandemic infection such as Coronavirus disease (COVID-19):** This may have an adverse impact on the macro economic factors such as energy demand and oil/gas pricing.

Table 4 - Financial summary

Date	5/12/23					Bell Potter Securities														
Price	A\$/sh	0.026					Stuart Howe (showe@bellpotter.com.au, +61 3 9235 1856)													
Valuation	A\$/sh	0.09																		
PROFIT AND LOSS											FINANCIAL RATIOS									
Year ending 30 June	Unit	2023a	2024e	2025e	2026e	2027e	Year ending 30 June	Unit	2023a	2024e	2025e	2026e	2027e							
Revenue	A\$m	8	-	-	269	271	VALUATION													
Expenses	A\$m	(7)	(2)	(2)	(51)	(52)	EPS (adjusted)	Ac/sh	0.1	(0.0)	(0.2)	5.7	0.6							
EBITDA	A\$m	1	(2)	(2)	219	219	EPS growth (Acps)	%	na	-160%	na	na	-90%							
Depreciation & amortisation	A\$m	(0)	-	-	(33)	(37)	PER	x	32.3x	-53.7x	-15.3x	0.5x	4.6x							
EBIT	A\$m	1	(2)	(2)	186	181	DPS	Ac/sh	-	-	-	-	-							
Net interest expense	A\$m	0	1	(3)	(8)	(3)	Franking	%	0%	0%	0%	0%	0%							
Profit before tax	A\$m	1	(1)	(5)	178	178	Yield	%	0%	0%	0%	0%	0%							
Tax expense	A\$m	-	-	-	(18)	(162)	FCF/share	Acps	0.1	(0.2)	(5.3)	5.6	2.0							
NPAT (reported)	A\$m	1	(1)	(5)	161	16	FCF yield	%	2%	-6%	-204%	214%	76%							
Adjustments	A\$m	1	-	-	-	-	EV/EBITDA	x	28.6x	-19.0x	-19.0x	0.2x	0.2x							
NPAT (adjusted)	A\$m	2	(1)	(5)	161	16	LIQUIDITY & LEVERAGE													
CASH FLOW STATEMENT											Net debt / (cash)			A\$m	(33)	(29)	120	(36)	(91)	
Year ending 30 June	Unit	2023a	2024e	2025e	2026e	2027e	Net debt / Equity			%	-78%	-68%	284%	-85%	-216%					
OPERATING CASH FLOW											Net debt / Net debt + Equity			%	-349%	-210%	74%	-559%	187%	
Receipts from customers	A\$m	1	2	-	238	278	Net debt / EBITDA			x	-24.7x	14.3x	-60.1x	-0.2x	-0.4x					
Payments to suppliers and employees	A\$m	(6)	(5)	(2)	(45)	(53)	EBITDA /net int expense			x	-6.3x	3.1x	-0.7x	28.7x	67.5x					
Tax paid	A\$m	-	-	-	(18)	(162)	PROFITABILITY RATIOS													
Net interest	A\$m	0	1	(3)	(8)	(3)	EBITDA margin			%	16%	na	na	81%	81%					
Other	A\$m	-	-	-	-	-	EBIT margin			%	14%	na	na	69%	67%					
Operating cash flow	A\$m	(4)	(2)	(5)	167	59	Return on assets			%	6%	-3%	-4%	56%	4%					
INVESTING CASH FLOW											Return on equity			%	7%	-4%	-14%	143%	8%	
Capex	A\$m	(3)	(2)	(144)	(11)	(3)	ASSUMPTIONS													
Other	A\$m	8	-	-	-	-	Year ending 30 June													
Investing cash flow	A\$m	5	(2)	(144)	(11)	(3)	Brent crude oil price (real)			US\$/bbl	79	71	57	57	57					
FINANCING CASH FLOW											UK average gas price (real)			£/Mscf	2.0	9.6	10.2	9.5	8.4	
Debt proceeds/(repayments)	A\$m	-	30	140	-	-	Anning & Somerville contract price (real)			GBp/therm	20	95	102	95	84					
Dividends paid	A\$m	-	-	-	-	-	Equivalent A\$/GJ			A\$/GJ	3	16	17	16	14					
Proceeds share issues (net, incl. options)	A\$m	29	-	-	-	-	Currency			£/A\$	0.75	0.55	0.56	0.56	0.55					
Other	A\$m	-	-	-	-	-	Anning & Somerville production (gross)			Bcf	-	-	-	39.4	44.5					
Financing cash flow	A\$m	29	30	140	-	-	Anning & Somerville production (net to HHR)			Bcf	-	-	-	15.7	17.8					
Change in cash	A\$m	30	26	(9)	156	55	Anning & Somerville production (net to HHR)			PJ	-	-	-	16.7	18.8					
Free cash flow	A\$m	1	(4)	(149)	156	55	VALUATION (Discount rate 8.0%)													
BALANCE SHEET											Unrisked					HHR	Unrisked	Risk	Riskd	
Year ending 30 June	Unit	2023a	2024e	2025e	2026e	2027e	100% \$m					% equity	HHR \$m	% disc	HHR \$m					
ASSETS											Anning and Somerville - Total to HHR (Phase 1)						655	307	30%	215
Cash	A\$m	33	59	50	206	261	Hodgkin & Lovelace (Phase 2)						302	40%	121	80%	24			
Receivables	A\$m	2	-	-	32	25	Exploration						100%			12				
Inventories	A\$m	-	-	-	-	-	Total projects									251				
Capital assets	A\$m	3	8	152	130	96	Corporate overhead assumption									-20				
Other assets	A\$m	0	0	0	0	0	Enterprise value									231				
Total assets	A\$m	38	67	202	368	383	Net debt (diluted)									-35				
LIABILITIES											Equity value									266
Creditors	A\$m	3	0	0	6	5	Diluted shares on issue m									2,871				
Borrowings	A\$m	-	30	170	170	170	Equity value A\$/sh									0.09				
Provisions	A\$m	-	-	-	-	-														
Other liabilities	A\$m	-	-	-	-	-														
Total liabilities	A\$m	3	30	170	176	175														
NET ASSETS																				
Share capital	A\$m	42	42	42	42	42														
Reserves	A\$m	2	2	2	2	2														
Accumulated losses	A\$m	(9)	(8)	(12)	148	164														
Non-controlling interest	A\$m	(0)	(0)	(0)	(0)	(0)														
SHAREHOLDER EQUITY	A\$m	36	37	32	192	208														
Weighted average shares	A\$m	2,324	2,809	2,809	2,809	2,809														

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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Research Coverage & Policies

For Bell Potter Securities' Research Coverage Decision Making Process and Research Independence Policy please refer to our company website: <https://bellpotter.com.au/research-independence-policy/>.

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The Price appearing in the Recommendation panel on page 1 of the Research Report is the Closing Price on the Date of the Research Report (appearing in the top right hand corner of page 1 of the Research Report), unless a before midday (am) time appears below the Date of the Research Report in which case the Price appearing in the Recommendation panel will be the Closing Price on the business day prior to the Date of the Research Report.

Availability

The completion and first dissemination of a Recommendation made within a Research Report are shortly after the close of the Market on the Date of the Research Report, unless a before midday (am) time appears below the Date of the Research Report in which case the Research Report will be completed and first disseminated shortly after that am time.

Disclosure: Bell Potter Securities acted as Joint Lead Manager to HHR's \$20m placement in April 2023 and received fees for that service.

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