

## Increasing the Stakes in China

### Investment Highlights

- Production down at Maari.** HZN's share of production for the June Q was 0.12kbbbls, implying a gross average field rate of ~13kbopd, well down on projected production rates of +20kbopd. This is due to ongoing issues with the ESP's. Currently 8 of 9 wells are online with the field at ~17kbopd and we have scaled-back our production forecasts for the field. Studies are ongoing into an expanded field development to fully produce the M2A and Manaia volumes. Mapping of the recently acquired 2D and 3D seismic in PEP51313 continued during the Q, with plans to drill a well on the Matariki trend in early 2012, which will provide a key catalyst.
- HZN ups the stakes in China.** During the period HZN announced the acquisition of an additional 25% stake in Block 22/12, providing an increased 12.25% interest in the development project - funded via an \$80m convertible bond issue. The deal makes considerable sense given HZN's existing stake in the project, however its balance sheet will be stretched over the coming 2-year period to fund projected expenditure. We forecast an additional \$80m is required to meet the Phase-1 Beibu project, Stanley development, Elevala Ketu appraisal drilling and a well in New Zealand in early 2012.
- PNG to provide key catalysts.** Appraisal drilling in PNG has significantly de-risked the project and looks likely to deliver upside on the original volumes, to be released this Q. The current drilling of the Sepalosiphon-1 will provide a free catalyst for HZN, however testing of an estimated 26mmbbbls at Elevala/Ketu will be the key event with Elevala-2 scheduled for October, followed by Ketu-2.
- We maintain our BUY recommendation with a price target of \$0.47/sh.** HZN is a standout from its peers with a pipeline of development projects - yet we caution that its increased stake in China will increase funding risk and the need for its assets to perform. It has suggested plans to fund its future commitments via additional debt funding, which is achievable against its reserves bank, but equity is likely also. Despite the increased funding requirements, we maintain our BUY given its solid growth portfolio and material upside to be tested in PNG over the coming months.

26 July 2011

12mth Rating

**BUY**

Price	A\$	0.33
Target Price	A\$	0.47
12m Total Return	%	43.9

RIC: **HZN.AX**

BBG: **HZN AU**

Shares o/s	m	1130.3
Free Float	%	100.0
Market Cap.	A\$m	367.4
Net Debt (Cash)	A\$m	54.6
Net Debt/Equity	%	137.5
3m Av. D. T'over	A\$m	0.69
52wk High/Low	A\$	0.42/0.28
2yr adj. beta		1.27

**Valuation:**

Methodology		DCF
Value per share	A\$	0.47

**Analyst:**

**Scott Simpson**

**Phone:**

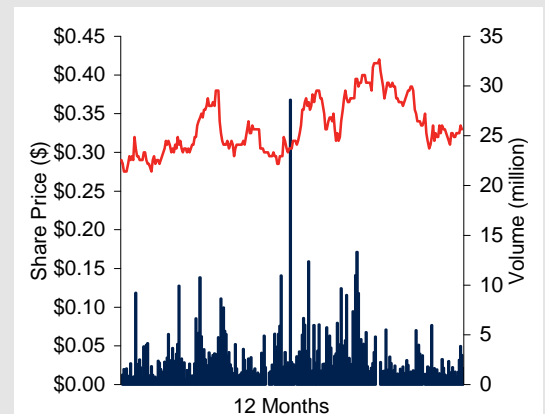
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Year End June 30	2009A	2010A	2011F	2012F	2013F
<b>A\$</b>					
Reported NPAT (\$m)	(2.7)	58.6	42.0	23.0	32.3
Recurrent NPAT (\$m)	(2.7)	22.1	34.6	23.0	32.3
Recurrent EPS (cents)	(0.2)	1.9	3.1	2.0	2.9
EPS Growth (%)	na	na	74.8	(31.1)	33.7
PER (x)	(138.0)	16.8	10.6	16.0	11.4
EBITDA (\$m)	3.3	44.1	66.2	59.3	98.6
EV/EBITDA (x)	140.3	9.5	6.8	8.3	5.4
Capex (\$m)	35.1	8.7	16.3	106.6	47.9
Free Cashflow	(52.6)	20.0	27.0	(106.1)	0.4
FCFPS (cents)	(4.5)	1.8	2.4	(9.4)	0.0
PFCF (x)	(7.2)	18.5	13.6	(3.5)	905.5
DPS (cents)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0	0.0

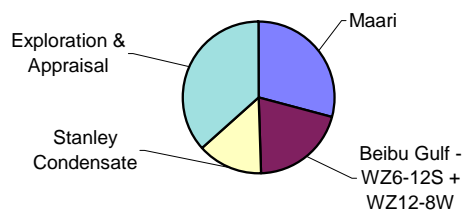
### 12 Month Share Price Performance



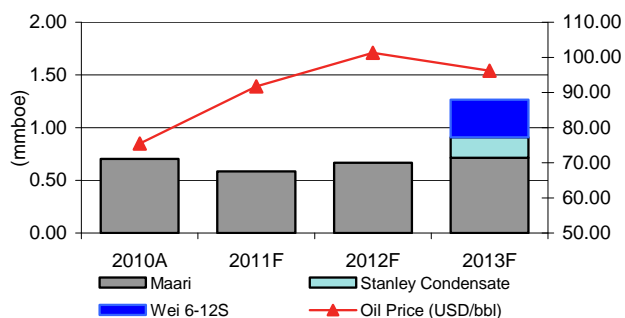
Performance %	1mth	3mth	12mth
Absolute	-7.5	-22.5	10.7
Rel. S&P/ASX 300	-3.0	-10.1	9.9

Horizon Oil Ltd		\$0.33	
Valuation	A\$m	A\$/sh	
Maari	178	0.16	
Beibu Gulf - WZ6-12S + WZ12-8W	122	0.11	
Stanley Condensate	85	0.08	
Exploration & Appraisal	223	0.20	
Corporate	(25)	(0.02)	
Cash - as at March Q	61	0.05	
Debt as at June Q plus additional \$40m	(115)	(0.10)	
<b>Total @ 10% Discount Rate</b>	<b>529</b>	<b>0.47</b>	
<b>Price Target</b>		<b>0.47</b>	
<b>Valuation Sensitivity</b>	<b>-10%</b>	<b>0%</b>	<b>+10%</b>
Oil Price Sensitivity (A\$/sh)	0.43	0.47	0.51
Exchange Rate Sensitivity (A\$/sh)	0.49	0.47	0.45

### Valuation Summary of Operating Assets



### Production Summary



### Reserves & Resources

Net Reserves - Sep 2010	Oil/Cond (mmbbl)	Gas (bcf)	Total (mboe)
<b>2P Reserves</b>			
Maari	6	0	6
Block 22/12 Wei 6-12+12-8W	6	0	6
Block 22/12 Wei 12-8E	5	0	5
<b>Total Group</b>	<b>17</b>	<b>0</b>	<b>17</b>

### Directors

Name	Position
Fraser Ainsworth	Chariman
Brent Emmett	Managing Director & CEO
Michael Sheridan	Company Secretary & CFO
John Humphrey	Non-Executive Director
Robert Laws	Non-Executive Director
Gerrit J de Nys	Non-Executive Director

### Substantial Shareholders

	Shares (m)	%
Acorn Capital Ltd	96.0	8.5
CBA	72.1	7.4%

Commodity Assumptions	Year End June 30			
	2010A	2011F	2012F	2013F
AS: US\$	0.89	0.99	1.02	0.98
Crude Oil - WTI (USD/bbl)	75.43	91.72	101.25	96.18

Production Summary	2010A	2011F	2012F	2013F
<b>Maari</b>				
Oil/Condensate (mmb/)	0.7	0.6	0.7	0.7
Gas (PJ)	0.0	0.0	0.0	0.0
Total (mmb/oe)	0.7	0.6	0.7	0.7
<b>Wei 6-12S</b>				
Oil/Condensate (mmb/)	0.0	0.0	0.0	0.4
Gas (PJ)	0.0	0.0	0.0	0.0
Total (mmb/oe)	0.0	0.0	0.0	0.4
<b>Stanley Condensate</b>				
Oil/Condensate (mmb/)	0.0	0.0	0.0	0.2
Gas (PJ)	0.0	0.0	0.0	0.0
Total (mmb/oe)	0.0	0.0	0.0	0.2
<b>Total (mmb/oe)</b>	<b>0.7</b>	<b>0.6</b>	<b>0.7</b>	<b>1.3</b>
<b>Total (mboepd)</b>	<b>1.92</b>	<b>1.60</b>	<b>1.83</b>	<b>3.46</b>

Profit & Loss (US\$m)	2010A	2011F	2012F	2013F
<b>Sales Revenue</b>	<b>48.0</b>	<b>59.4</b>	<b>67.5</b>	<b>117.0</b>
Other Income	0.2	23.3	2.2	0.3
Operating Costs	2.8	9.4	3.4	13.4
Royalties	0.1	1.5	0.0	1.9
Exploration Exp.	0.2	0.0	0.0	0.0
Corporate/Admin	5.7	6.3	5.7	5.8
<b>EBITDA</b>	<b>39.4</b>	<b>65.4</b>	<b>60.6</b>	<b>96.2</b>
Depn & Amort	12.1	11.0	13.5	26.9
<b>EBIT</b>	<b>27.3</b>	<b>54.4</b>	<b>47.2</b>	<b>69.2</b>
Financing Cost	3.2	2.5	5.1	8.4
<b>Operating Profit</b>	<b>24.1</b>	<b>51.9</b>	<b>42.1</b>	<b>60.9</b>
Abnormals - Pre Tax	(32.6)	(7.3)	0.0	0.0
Tax expense	4.3	17.7	18.6	29.4
Minorities	0.0	0.0	0.0	0.0
Abnormals - Post Tax	0.0	0.0	1.0	1.0
<b>NPAT</b>	<b>52.3</b>	<b>26.8</b>	<b>24.5</b>	<b>32.5</b>
<b>Normalised NPAT</b>	<b>19.7</b>	<b>34.2</b>	<b>23.5</b>	<b>31.5</b>

Unit Revenue / Costs	2010A	2011F	2012F	2013F
Sales Revenue / boe (\$/boe)	68.5	101.5	101.1	92.5
Cash OPEX / boe (\$/boe)	14.4	28.6	16.0	16.4
Non-cash OPEX / boe (\$/boe)	15.3	19.8	17.7	21.6
EBIT / boe (\$/boe)	39.0	93.0	70.7	54.8
NPAT / boe (\$/boe)	74.9	58.4	35.3	24.9

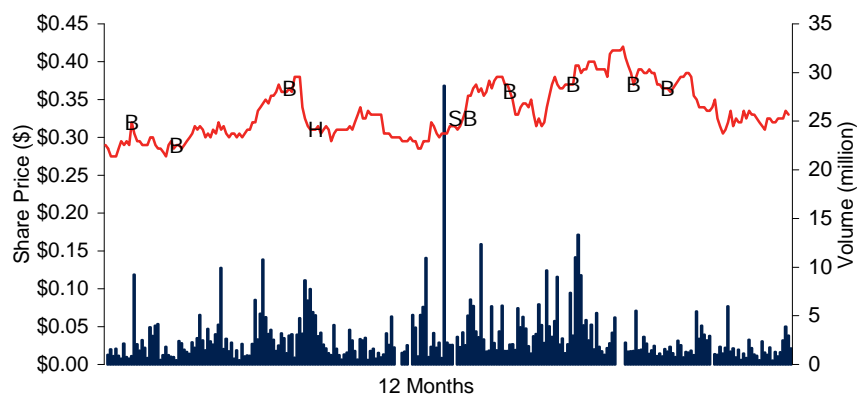
Cash Flow (US\$m)	2010A	2011F	2012F	2013F
Adjusted Net Profit	19.9	34.2	23.5	31.5
+ Interest/Tax/Expl Exp	7.7	20.3	23.6	37.8
- Interest/Tax/Expl Inc	17.8	24.6	52.9	41.8
+ Depn/Amort	12.1	11.0	13.5	26.9
+/- Other	0.8	9.2	(7.3)	(7.3)
<b>Operating Cashflow</b>	<b>22.7</b>	<b>50.1</b>	<b>0.5</b>	<b>47.1</b>
- Capex (+asset sales)	7.8	16.1	109.0	46.7
- Working Capital Increase	0.0	0.0	0.0	0.0
<b>Free Cashflow</b>	<b>14.9</b>	<b>34.0</b>	<b>(108.5)</b>	<b>0.4</b>
- Dividends (ords & pref)	0.0	0.0	0.0	0.0
+ Equity raised	0.2	0.5	0.0	0.0
+ Debt drawdown (repaid)	(28.8)	55.6	45.0	35.0
+ Other	29.6	(52.2)	0.0	0.0
<b>Net Change in Cash</b>	<b>16.0</b>	<b>37.9</b>	<b>(63.5)</b>	<b>35.4</b>
Cash at End Period	26.5	64.5	0.9	36.3
Net Cash/(Debt)	4.5	(15.5)	(124.1)	(123.7)

Balance Sheet (US\$m)	2010A	2011F	2012F	2013F
Cash	26.5	64.5	0.9	36.3
Total Assets	171.6	240.0	311.2	375.3
Total Debt	40.5	80.0	127.6	156.4
Total Liabilities	57.3	97.8	145.4	178.1
Shareholders Funds	114.4	142.2	165.8	197.2

### Ratios

Net Debt/Equity (%)	na	10.9	74.8	62.7
Interest Cover (x)	8.5	22.0	9.3	8.3
Return on Equity (%)	45.8	18.9	14.8	16.5

## Recommendation History



Date	Type	Target Price	Share Price	Recommendation	Return
09 Aug 10	Research Note	0.40	0.31	B	
01 Sep 10	Research Note	0.41	0.29	B	-6.5%
01 Nov 10	Research Note	0.73	0.36	B	24.1%
15 Nov 10	Oil and Gas Review	0.32	0.32	H	-11.1%
01 Feb 11	Research Note	0.39	0.33	SB	
25 Feb 11	Research Note	0.44	0.36	B	9.1%
31 Mar 11	Event Impact Email	Under Review	0.38	B	5.6%
31 Mar 11	Research Note	0.46	0.37	B	-2.6%
03 May 11	Research Note	0.45	0.38	B	2.7%
20 May 11	Oil & Gas Review	0.49	0.37	B	-2.6%
	Current Share Price		0.33		-10.8%

**Stock recommendations:** Investment ratings are a function of Patersons expectation of total return (forecast price appreciation plus dividend yield) within the next 12 months. The investment ratings are Buy (expected total return of 10% or more), Hold (-10% to +10% total return) and Sell (> 10% negative total return). In addition we have a Speculative Buy rating covering higher risk stocks that may not be of investment grade due to low market capitalisation, high debt levels, or significant risks in the business model. Investment ratings are determined at the time of initiation of coverage, or a change in target price. At other times the expected total return may fall outside of these ranges because of price movements and/or volatility. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. This Document is not to be passed on to any third party without our prior written consent.

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