FY14: Positive Stanley drilling results

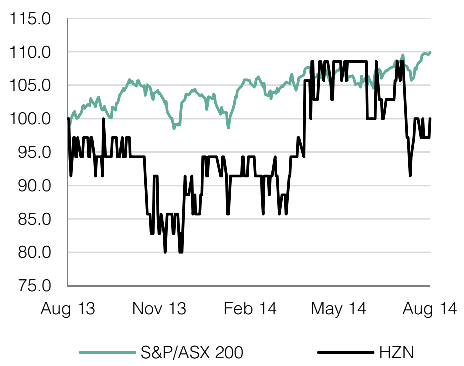
Overweight

Price target	$0.50 (from $0.55)
Share price	$0.35
52-week range	$0.28 - $0.39
Forecast price return	42.9%
Forecast dividend return	0.0%
Forecast total return	42.9%
Market cap	$456m

Forecasts and ratios

Year end Jun	13	14	15f	16f	17f
NPAT $m	3	-4	32	29	40
EPS c	0.3	-0.3	2.5	2.2	3.0
EPS growth %	-55.0	-200.0	917.7	-8.8	35.2
P/E x	97.9	-110.2	13.3	14.6	10.8
EV/EBITDA x	18.8	8.0	5.0	5.9	4.5
DPS c	0.0	0.0	0.0	0.0	0.0
Yield %	0.0	0.0	0.0	0.0	0.0

Price relatives Starting index and share price rebased to 100



Event – HZN released its FY14 results

- **Underlying NLAT of USD3.8m was below consensus NPAT USD18.4m and CBAf NPAT USD18.4m**. Difference to our forecast relates to higher-than-expected operating costs largely related to Maari, corporate costs associated with ROC merger, tax and exploration expenses. **No dividend as expected.**

- **Stanley development progressing - encouraging initial results from recent development well.** Development continues on the Stanley gas condensate project in PNG with the Stanley-5 development well recently completed. The well intersected a gas column with 96m of net pay across the Toro and Kimu reservoirs, with better-than-expected reservoir characteristics observed. On production test the well flowed at 68mmscf/d, in line with expectations. Two development wells are now completed in Stanley-2 and Stanley-5, with Stanley-3 set to spud on 31 August. Liquids content of 30bbls/mmscf are supportive of economics of the project. The field is expected to commence at production levels of ~4kbbls/d of condensate in 2H 2016.

- **Elevala/Ketu/Tingu FEED studies continue, ahead of possible FID in early 2015.** Work continues on FEED studies for the development plan of the Elevala/Tingu/Ketu fields. The JV submitted an Environmental Impact Statement (EIS) in June and is progressing the project, targeting to be in a position to make a development decision in early 2015. The JV has had encouraging test results to date from the fields. Production testing of the Ketu-2 appraisal well delivered strong gas and condensate flows, with the well flowing consistently at 35-40mmscfd with no water and minimal CO_2 and H_2S. Liquids content is also positive, with a stabilised rate of 50-60bbl/mmscf. The positive results from Ketu-2 follow good initial results from nearby Tingu-1, which produced a good initial average production rate of 48mmscf/d with no water, which is positive for future development from the Elevala sandstone reservoir. Also encouraging was the initial average liquids content of 65bbl/mmscf achieved over the test period. HZN has confirmed that Tingu has added a further ~10.8mmboe to its net contingent resource position, taking HZN's net 2C resources to ~57.4mmboe for the Elevala/Tingu/Ketu fields.

- **Earnings and valuation changes** relate largely to updated modelling of PNG assets following the recent completion of the Osaka Gas deal.

Figure 1: Earnings revisions

	FY15f			FY16f			FY17f		
	New	Old	Change	New	Old	Change	New	Old	Change
NPAT ($m)	32	39	-17.7%	29	50	-41.7%	40	92	-56.9%
EPS (c)	2.5	3.0	-18.0%	2.2	3.8	-41.9%	3.0	7.0	-57.0%

Source: CBA estimates

Investment view

- **We retain our Overweight recommendation with a revised price target $0.50ps**. We consider HZN to have a solid underlying business, with production from Maari and Beibu providing a strong base with upside potential. The addition of Osaka Gas to the PNG JV should enhance development potential. Recent drilling success at Elevala, Ketu and Tingu has resulted in resource upgrades and should offer further growth potential.

Lachlan Cuskelly T. +612 9118 1981
E. lachlan.cuskelly@cba.com.au

Luke Smith T. +612 9118 2868
E. luke.smith@cba.com.au

Financials

Profit & Loss (USDm)	FY13	FY14	FY15f	FY16f	FY17f
Production (mmboe)	**0.5**	**1.4**	**1.9**	**1.6**	**1.7**
Sales Revenue	48	144	163	152	174
EBITDAX	**28**	**99**	**107**	**98**	**120**
Exploration expense	-1	-11	-3	-3	-2
EBITDA	**27**	**89**	**104**	**95**	**118**
Depn & Amortisation	-9	-40	-34	-28	-36
Impairments	0	0	0	0	0
EBIT	**18**	**49**	**70**	**66**	**82**
Net Interest	-8	-19	-17	-17	-18
Profit Before Tax	10	30	53	49	64
Tax expense	-7	-17	-21	-20	-24
NPAT (Reported)	**3**	**13**	**32**	**29**	**40**
Preference Div Paid					
Exceptional Items (post-tax)	0	17	0	0	0
NPAT (Underlying)	**3**	**-4**	**32**	**29**	**40**
EPS (Underlying)	**0**	**0**	**2**	**2**	**3**

Balance Sheet (USDm)	FY13	FY14	FY15f	FY16f	FY17f
Cash and equivalents	19	99	88	54	16
Receivables	20	15	17	16	19
Inventories	8	5	6	6	6
Other current assets	1	2	2	2	2
Current assets	**47**	**121**	**113**	**78**	**43**
Oil & Gas properties	286	293	311	355	347
Exploration asset	93	75	93	111	124
Other non-current assets	50	26	26	26	26
Non-current assets	**429**	**394**	**429**	**492**	**497**
Total Assets	**476**	**515**	**542**	**570**	**540**
Payables	40	36	31	29	30
Interest bearing liabilities	15	44	44	44	44
Other current liabilities	2	20	20	20	20
Current Liabilities	**57**	**100**	**95**	**94**	**94**
Interest bearing liabilities	181	143	143	143	73
Other non-current liabilities	71	49	49	49	49
Non Current Liabilities	**252**	**192**	**192**	**192**	**122**
Total Liabilities	**309**	**292**	**287**	**286**	**216**
Net Assets	**167**	**223**	**255**	**284**	**323**
Total shareholder funds	**167**	**223**	**255**	**284**	**323**

Cash Flow (USDm)	FY13	FY14	FY15f	FY16f	FY17f
Net Operating Cash Flow	**15**	**65**	**91**	**89**	**122**
Capital expenditure	-96	-50	-51	-73	-28
Exploration expenditure	-30	-42	-22	-22	-15
Other	20	77	0	0	0
Investing Cash Flow	**-105**	**-16**	**-73**	**-94**	**-43**
Dividends Paid	0	0	0	0	0
Equity raised	1	47	0	0	0
Net Borrowings	89	-15	0	0	-70
Other	0	0	0	0	0
Financing Cash flow	**89**	**32**	**0**	**0**	**-70**
Increase/(decrease) in cash	**0**	**80**	**18**	**-6**	**9**

Financial Ratios	FY13	FY14	FY15f	FY16f	FY17f
EBITDA margin	56.8%	45.0%	63.8%	62.3%	67.7%
EBIT margin	37.9%	17.2%	43.0%	43.7%	47.0%
Return on equity	2.1%	-2.0%	13.4%	10.9%	13.0%
Net Debt (m)	177	89	100	133	102
Gearing (ND / ND+E) (book)	51%	28%	28%	32%	24%
Gearing (ND / ND+E) (market)	35%	17%	19%	24%	19%
Interest cover	2	1	4	4	5

Assumptions	FY13	FY14	FY15f	FY16f	FY17f
AUD/USD	1.03	0.92	0.89	0.85	0.88
WTI Oil (USD/bbl)	92.2	96.9	90.2	99.8	106.3
Brent Oil (USD/bbl)	109.1	105.2	97.5	99.7	106.2

Market Information	
Recommendation	Overweight
Price Target (AUD)	0.50
Last Price (AUD)	0.35
Issued Capital (m)	1,302
Market Capitalisation (AUDm)	456
Year end	June

Pricing	FY13	FY14	FY15f	FY16f	FY17f
EPS Underlying (USc)	0.3	-0.3	2.5	2.2	3.0
PE Ratio	97.9	-110.2	13.3	14.6	10.8
P/B	2.0	1.9	1.7	1.5	1.3
DPS (USc)	0.0	0.0	0.0	0.0	0.0
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Valuation	AUDm	AUDps	Risk	Reserves	USD/boe
Operations				**mmboe**	
Maari	189	0.15	100%	9	19.1
Beibu Gulf	229	0.18	100%	7	27.4
Stanley Liquids	53	0.04	100%	2	19.1
Elevala/Ketu Liquids	212	0.16	100%	10	18.8
Total Operations	**682**	**0.52**		**28**	**21.1**
Other Assets	71	0.05			
Net Cash/(Debt)	-96	-0.07			
Total Valuation	**658**	**0.51**			

Production	FY13	FY14	FY15f	FY16f	FY17f
Sales Gas, Ethane (PJ)	0	0	0	0	0
Condensate (mmbbl)	0.0	0.0	0.0	0.0	0.3
LPG (kt)	0	0	0	0	0
Crude Oil (mmbbl)	0.5	1.4	1.9	1.6	1.4
Total (mmboe)	**0.5**	**1.4**	**1.9**	**1.6**	**1.7**
Maari (mmboe)	0.3	0.2	0.5	0.5	0.5
Beibu Gulf (mmboe)	0.2	1.2	1.3	1.1	0.9
Stanley (mmboe)	0.0	0.0	0.0	0.0	0.3
Elevala/Ketu (mmboe)	0.0	0.0	0.0	0.0	0.0

Divisional EBIT (USDm)	FY13	FY14	FY15f	FY16f	FY17f
Maari	13	-10	37	36	38
Beibu Gulf	9	53	47	43	38
Stanley	0	0	0	0	20
Elevala/Ketu	0	0	0	0	0
Other	-4	-18	-13	-13	-13
Total EBIT (underlying)	**18**	**25**	**70**	**66**	**82**

Source: Company data, CBA estimates

Result overview

- **Underlying NLAT of USD3.8m was below consensus NPAT USD18.4m and CBAf NPAT USD18.4m**. Difference to our forecast relates largely to higher-than-expected operating costs largely related to Maari, corporate costs associated with ROC merger, higher tax and exploration expenses.
- **Reported NPAT of USD12.8m includes** a pre-tax gain on asset sales of USD23.8m related to the sale of an interest in PNG assets to Osaka Gas.
- No dividend as expected.

Figure 2: HZN FY14 result vs pcp and forecast

	2014f	2013	yoy %	2014f	Dif %	Dif $
Production (mmboe)	1.4	0.5	185%	1.4	0.0	0.0
Sales Volume (mmboe)	1.4	0.5	190%	1.4	0.0	0.0
Revenue	144.3	48.1	200%	144.3	0%	0.0
EBITDAX (pre significant items)	75.4	27.9	170%	88.5	-15%	-13.1
Exploration Expense	10.5	0.6	1636%	5.7	83%	4.8
D&A	40.0	9.1	340%	38.5	4%	1.6
EBIT (pre significant items)	24.9	18.2	37%	44.3	-44%	-19.4
Interest Expense	18.7	8.2	128%	17.6	6%	1.1
Tax expense (pre significant items)	10.0	6.6	53%	8.2	22%	1.8
Underlying NPAT	-3.9	3.5	n/a	18.4	n/a	-22.3

Source: Company data, CBA estimates

Company outlook

- **Stanley development progressing - encouraging initial results from recent development well.** Development continues on the Stanley gas condensate project in PNG. The Stanley-5 development well was recently completed, intersecting a gas column with 96m of net pay across Toro and Kimu reservoirs, with better-than-expected reservoir characteristics. On production test the well flowed at 68mmscf/d, in line with expectations. Two development wells are now completed in Stanley-2 and Stanley-5, with Stanley-3 set to spud on 31 August. Liquids content of 30bbls/mmscf are supportive of economics of the project. The field is expected to commence at production levels of ~4kbbls/d of condensate in 2H 2016.
- **Elevala/Ketu/Tingu FEED studies continue, ahead of possible FID in early 2015.** Work continues on FEED studies for the development plan of the Elevala/Tingu/Ketu fields. The JV submitted an EIS in June and is progressing the project, targeting to be in a position to make a development decision in early 2015. The JV has had encouraging test results to date from the fields. Production testing of the Ketu-2 appraisal well delivered strong gas and condensate flows, with the well flowing consistently at 35-40mmscfd with no water and minimal CO_2 and H_2S. Liquids content is also positive, with a stabilised rate of 50-60bbl/mmscf. The positive results from Ketu-2 follow good initial results from nearby Tingu-1, which produced a good initial average production rate of 48mmscf/d with no water, which is positive for future development from the Elevala sandstone reservoir. Also encouraging was the initial average liquids content of 65bbl/mmscf achieved over the test period. HZN has confirmed that Tingu has added a further ~10.8mmboe to its net contingent resource position, taking HZN's net 2C resources to ~57.4mmboe for the Elevala/Tingu/Ketu fields.
- **Further PNG exploration set to commence in October.** Good progress has been made on site preparations for the Nama-1 well in PPL 259 near the Stanley field in the PNG Western Province. Drilling on the Nama gas/condensate prospect is set to commence in late October. The potential resource size for the prospect is thought to be in line with Stanley (399bcf gas and 13mmbbl condensate).
- **Maari growth development program continues - Whio exploration well unsuccessful.** The Maari growth projects program incorporates four new production wells, one new injection well and a workover of an existing horizontal production well. HZN intends to complete the growth drilling campaign in FY15, and is targeting increasing gross production to 20kbbls/d. Drilling of the Whio-1 exploration well has proved to be unsuccessful, with the well failing to confirm commercial hydrocarbons. HZN had a free carry on the well from OMV.

Investment view

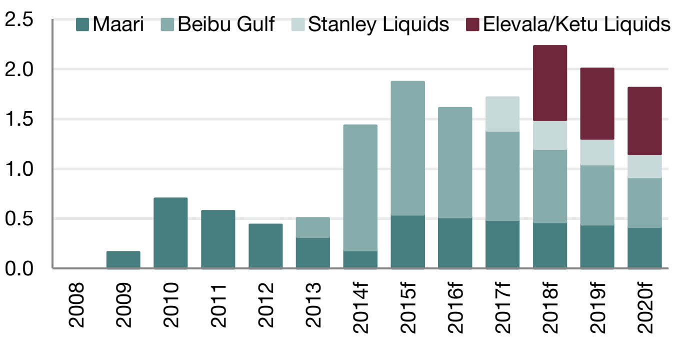
- **We retain our Overweight recommendation with a revised price target $0.50ps.**
- We consider HZN to have a solid underlying business, with production from Maari and Beibu providing a strong base with upside potential. The addition of Osaka Gas to the PNG JV should enhance development potential. Recent drilling success at Elevala, Ketu and Tingu has resulted in resource upgrades and should offer further growth potential.

Figure 3: HZN - valuation breakdown

HZN valuation	AUDm	AUDps	Risk	Reserves mmboe	USD/boe
Maari	189	0.15	100%	9	19.1
Beibu Gulf	229	0.18	100%	7	27.4
Stanley Liquids	53	0.04	100%	2	19.1
Elevala/Ketu Liquids	212	0.16	100%	10	18.8
Total Operations	**682**	**0.52**		28	21.1
Other Assets	146	0.11			
Net Cash/(Debt)	-96	-0.07			
Corporate	-75	-0.06			
Total Valuation	**658**	**0.51**			

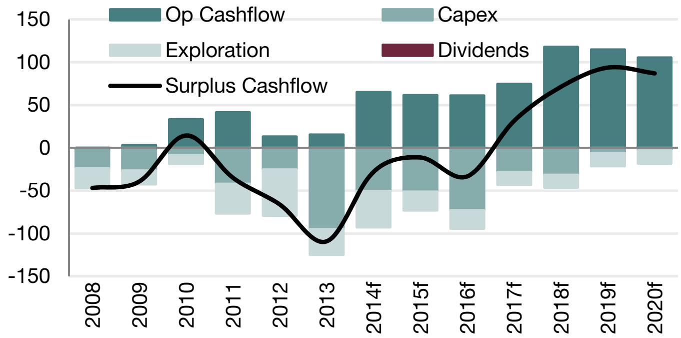
Source: Company data, CBA estimates

Figure 4: HZN - production (mmboe)



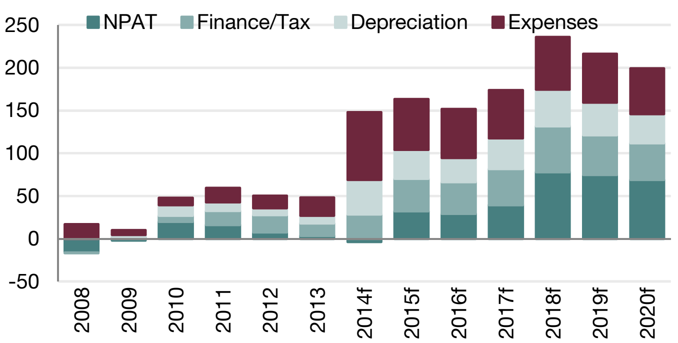
Source: Company data, CBA estimates

Figure 5: HZN - cash flow (USDm)



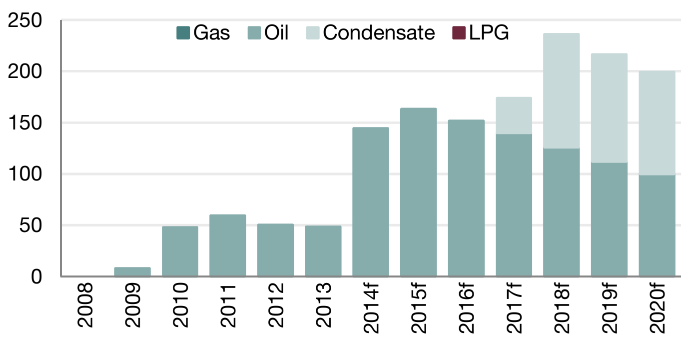
Source: Company data, CBA estimates

Figure 6: HZN - revenue to NPAT (USDm)



Source: Company data, CBA estimates

Figure 7: HZN - revenue by commodity (USDm)



Source: Company data, CBA estimates

Current recommendation definitions

CBA Institutional Equities investment recommendations are determined by the covering analyst and reflect the analyst's assessment of a stock's expected total shareholder return (TSR). Stock expected TSR is calculated as the difference between the analyst's 12-month price target and the current share price plus the forecast dividend yield.

Overweight: Stocks with an Overweight recommendation represent the most attractive stocks under the analyst's coverage. They are generally forecast to generate higher TSR compared to the rest of the analyst's coverage.

Neutral: Stocks with a Neutral recommendation are less attractive than stocks with an Overweight recommendation. They are generally forecast to generate lower TSR compared to stocks with an Overweight recommendation in the analyst's coverage.

Underweight: Stocks with an Underweight recommendation are the least attractive stocks. They are generally forecast to generate lower TSR compared to stocks with a Neutral recommendation in the analyst's coverage.

Note: CBA's previous recommendations prior to 9 November 2012 were:

Buy: Stocks with a Buy recommendation represent the most attractive stocks under the analyst's coverage. They are forecast to generate significantly positive expected total shareholder returns.

Hold: Stocks with a Hold recommendation are less attractive than stocks with a Buy recommendation. They are forecast to generate flat to slightly positive expected total shareholder returns.

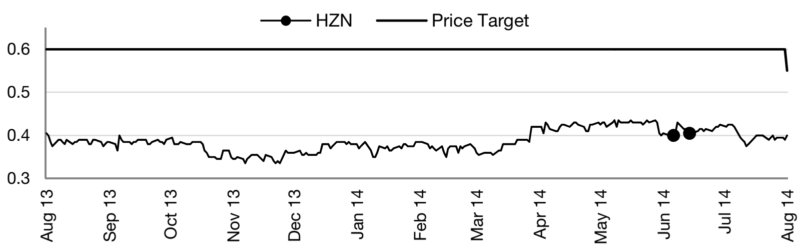
Sell: Stocks with a Sell recommendation are the least attractive stocks. They are forecast to generate flat or negative expected total shareholder returns.

CBA's previous recommendations prior to 25 January 2010 were:

Short term (over 6 months): Buy – appreciate by >10%, Accumulate – increase between 2% and 10%, Reduce – increase by less than 2% or fall by up to 5%,Sell – fall by >5%.

Long term (24 months) Outperform (O / P) – exceed market return by >5%, Market Perform (M / P) – be in line with market return, +/-5%, Under Perform (U / P) – be less than market return by >5%.

One year history of price target and recommendation changes



Date	Price Target ($)	Recommendation
27/08/2014	0.50	OVERWEIGHT

Source: CBA Equities, IRESS

Disclosure and Disclaimer Appendix

Companies Mentioned

Company Name	
Horizon Oil Limited	HZN, AUD0.35, Overweight, PT AUD0.50
Osaka Gas	OMVV.VI, JPY426.1, Not Rated
Osaka Gas Co Ltd	9532.T, JPY426, Not Rated
ROC Oil Company Limited	ROC, AUD0.68, Neutral, PT AUD0.69

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Equities Research

Head of Research Management
Sarah McWilliams +612 9118 1449

Consumer
Food & Beverage
Andrew McLennan +612 9118 1199
Sam Teeger +612 9118 1184
Gaming
Alice Bennett +613 9675 7118
Lindsay Bettiol +613 9675 7921
Media
Alice Bennett +613 9675 7118
Nathan Burley +613 9675 7029
Lindsay Bettiol +613 9675 7921
Retail – Discretionary & Staples
Andrew McLennan +612 9118 1199
Sam Teeger +612 9118 1184

Energy
Luke Smith +612 9118 2868
Lachlan Cuskelly +612 9118 1981

Financials
Financial Institutions Group (FIG)
Tim Rocks (Head of FIG) +612 9303 1663
FIG - Banks
Tim Rocks +612 9303 1663
Jeff Cai +612 9118 1186
FIG - Diversified Financials
Ross Curran +612 9118 1181
Avinash Srinivasan +612 9303 1981
FIG - Insurance
Ross Curran +612 9118 1181
Avinash Srinivasan +612 9303 1981
Property
Rhiannon Sharpe +612 9303 8049

Healthcare
Bruce Du +613 9675 6244

Industrials and Utilities
Developers & Contractors
Ben Brownette +612 9118 1190
Transport/Infrastructure
Matt Crowe +612 9118 1189
Vana Makaric +612 9118 1198
Utilities
Will Allott +612 9916 0946

For email: first name.surname@cba.com.au

* Except: David Jennings – jenninda@cba.com.au
Michael Ward – michael.ward1@cba.com.au
Nick Tuffley – nick.tuffley@asb.co.nz
Jane Turner – jane.turner@asb.co.nz
Christina Leung – christina.leung@asb.co.nz
Chris Tennent-Brown –chris.tennent-brown@asb.co.nz

Equities Research (cont)

Materials
Chemicals
Michael Ward* +612 9118 1139
Rahul Badethalav +612 9117 1243
Construction Materials
Michael Ward* +612 9118 1139
Rahul Badethalav +612 9117 1243
Paper & Packaging
Michael Ward* +612 9118 1139
Rahul Badethalav +612 9117 1243
Commodities
Lachlan Shaw +613 9675 8618
Vivek Dhar +613 9675 6183
Diversified Resources
Andrew Hines +613 9675 7443
Kofi Mensa +613 9675 7130
Metals & Mining/Gold
Andrew Knuckey +613 9675 6791
Paul Hodsman +613 9675 8532
Steel
Tomas Vasquez +612 9303 8149

Telecommunications
Nathan Burley +613 9675 7029
Alice Bennett +613 9675 7118
Lindsay Bettiol +613 9675 7921

Emerging Companies
Naveen Patney +612 9118 6391
Michael Peet +612 9303 1896
Tomas Vasquez +612 9303 8149

Equity Strategy
Tim Rocks +612 9303 1663
David Jennings* +612 9303 1750

Economics
Michael Blythe +612 9118 1101

Quantitative Research & Database
Nizar Torlakovic +612 9118 1178
Sidney Chow +612 9118 1200

Supervisory Analyst
Joe Pardea +612 9118 6388

Publishing +612 9118 1183

Fax (Sydney) +612 9118 1000

CommSec Retail
Craig James +612 9118 1806
Savanth Sebastian +612 9118 1805

Institutional Equities

Head of Institutional Equities
Jay MacGregor +612 9118 1204

Equity Distribution
Head of Institutional Cash Equities
Simon Greenaway +612 9117 7888

Equity Research Sales
Ben Shakespeare +612 9118 1447
Christine Leonard +612 9118 1442
Rod Hardwick +612 9118 1444
James Barratt +612 9117 0109
Jonas FitzGerald (Emerging Companies) +612 9118 1461
Angus Esslemont +612 9118 1471
Melissa George (Desk Manager) +612 9118 1446
Corporate Relations
Amanda Chamberlin +612 9118 1443
Mags Ni Mhaonaigh +612 9118 1448
Client Execution Services (CES)
Duncan Adam (Head of CES) +612 9117 0103
Christian Ford +612 9117 0102
Paul Welsh +612 9117 0101
Rod Ellis +612 9117 0105
Darren Hough +612 9117 0106
Matt Bromfield +612 9117 0107
Steven Sassine +612 9117 0108
Nicolas Thompson (Melbourne) +613 9675 6618
Anthony Brownlow (Electronic Execution) +612 9118 1463
Visakha Mayo (Electronic Execution) +612 9117 7035
US Sales
Stuart Nutting +1 212 848 9340

Global Markets Research
Commodities
Lachlan Shaw +613 9675 8618
Foreign Exchange
Richard Grace +612 9117 0080
Jarrod Kerr +612 9303 1766
Joseph Capurso +612 9118 1106
Elias Haddad +612 9118 1107
Peter Dragicevich +44 20 7710 5603
Andy Ji +65 6349 7056
Fixed Income
Adam Donaldson +612 9118 1095
Scott Rundell +612 9303 1577
Philip Brown +612 9118 1090
Tariq Chotani +612 9280 8058
Tally Dewan +612 9118 1105
Kevin Ward +612 9118 1960
Alex Stanley +44 20 7710 6994
Economics
Michael Blythe +612 9118 1101
Michael Workman +612 9118 1019
John Peters +612 9117 0112
Gareth Aird +612 9118 1100
Diana Mousina +612 9118 6394
Nick Tuffley* (NZ) +64 9301 5659
Jane Turner* (NZ) +64 9374 8185
Christina Leung* (NZ) +64 9369 4421
Chris Tennent-Brown* (NZ) +64 9301 5660

Fax (Sydney) +612 9118 1010