

Oil and Gas - SPAC (NOT RATED)

 INDUSTRY INSIGHT
 INDUSTRY: NEUTRAL

December 10, 2014

Not Rated

Too good to be TRUE?

Highlights

- **Margin of safety is widening ...** Three existing oil and gas undergraduate SPACs (Reach Energy, Cliq and Sona) are trading at ~13-16% discount to intrinsic cash value (Refer Fig 1). We understand that SPACs have requirement to place at least ~90% (Reach Energy has the highest of 94.75%) of fund raised into trust account. This theoretically will serve as the base value of the SPACs as investors can choose to vote against QAs and get back the cash value from trust account plus net interest earned. Hence, buying into these 3 SPACs now will provide base potential return of 15-19% (Refer Fig 1).
- **Too good to be TRUE?** We think the widening gap between share price and intrinsic cash value are due to i) plunged in oil price, ii) high participation from retail investors with limited institutional shareholders (range from 2% to 11%, Ref Fig 3) and iii) lack of instant arbitrage opportunity given the value can only be realised upon successful acquisition of QA or approaching end of 3 years' time frame.
- **Higher risk free returns than FD...** For investors with longer term horizon, in the worst case scenario, holding to maturity will provide attractive return of 17-29% (after taken into account interest earned of 3.2% pa, 10% tax on interest and other expenses, Ref Fig 2). This will translate to ~11-13% risk free return pa. which is significantly higher than average FD rate of 3.2% pa.
- **Downside protection while enjoying upside "option"...** Successful completion of QA could provide better upside. Based on the intrinsic cash value, we believe the market has mispriced the security due to misunderstanding of the SPAC structure. Hibiscus traded at a low of 52 sen and is currently trading at RM0.98 after successful completion of qualifying asset. Historically, Hibiscus (the only graduated SPAC) was traded at discount to intrinsic value but the discount was zeroed upon announcing QA and trading on premium towards completion of deal (Ref Fig 4). This underpinned our belief that intrinsic cash value will serve as base return with upside "option" from value accretive qualifying asset.
- **Current weak oil price environment provides better bargain power for undergraduate SPAC...** SPACs are cash companies looking for oilfield assets and should potentially be able to negotiate for better pricing especially in the declining oil price environment.

Risks

- Identification of qualifying asset takes > 3 year; Further market mispricing; Plunged in oil price.

Valuation

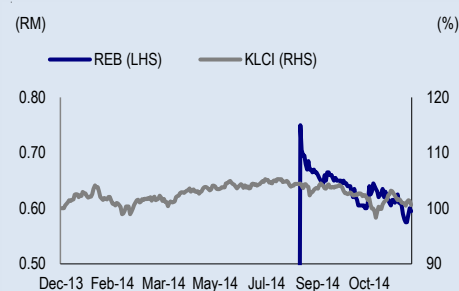
- Share prices should be underpinned by cash backing per share. The current discount provides unique opportunity to lock in long term (<3 years) returns.

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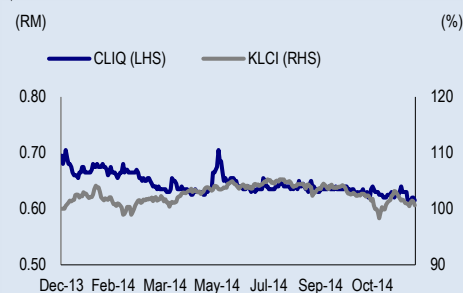
(603) 2176 2751

KLCI	1,738.1
Expected share price return	NA
Expected dividend return	NA
Expected total return	NA

Reach Energy



Cliq Energy



Sona Petroleum

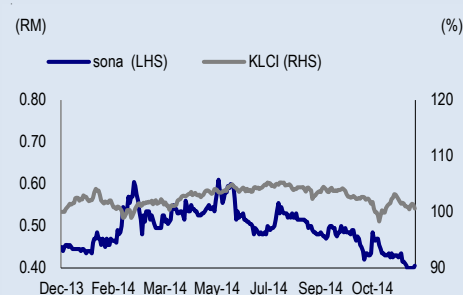


Figure #1: SPAC's Trust Balance Per Share

SPAC	Listing Price	Number of shares	Price	% in trust	Gross Trust Per Share		Gross Trust Per Share		Discount (%)
					@ IPO	Upside (%)	@ 3Q14	Upside (%)	
Reach	0.75	1277.80	0.60	94.8%	0.711	19%	0.711	19%	-16%
Cliq	0.75	630.90	0.62	90.0%	0.675	9%	0.729	18%	-15%
Sona	0.50	1410.70	0.40	90.0%	0.450	13%	0.462	15%	-13%
Hibiscus	0.75	891.60	0.98	90.0%	0.675				

Source: HLIB

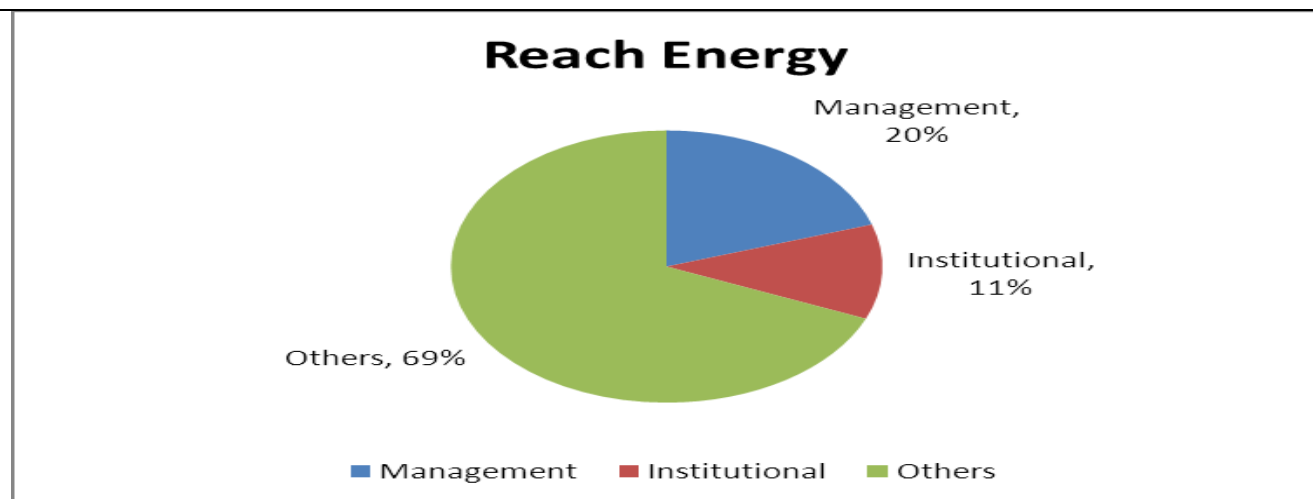
Note: In the case of liquidation, the trust balance only will distribute to shareholders exclude management and early investors.

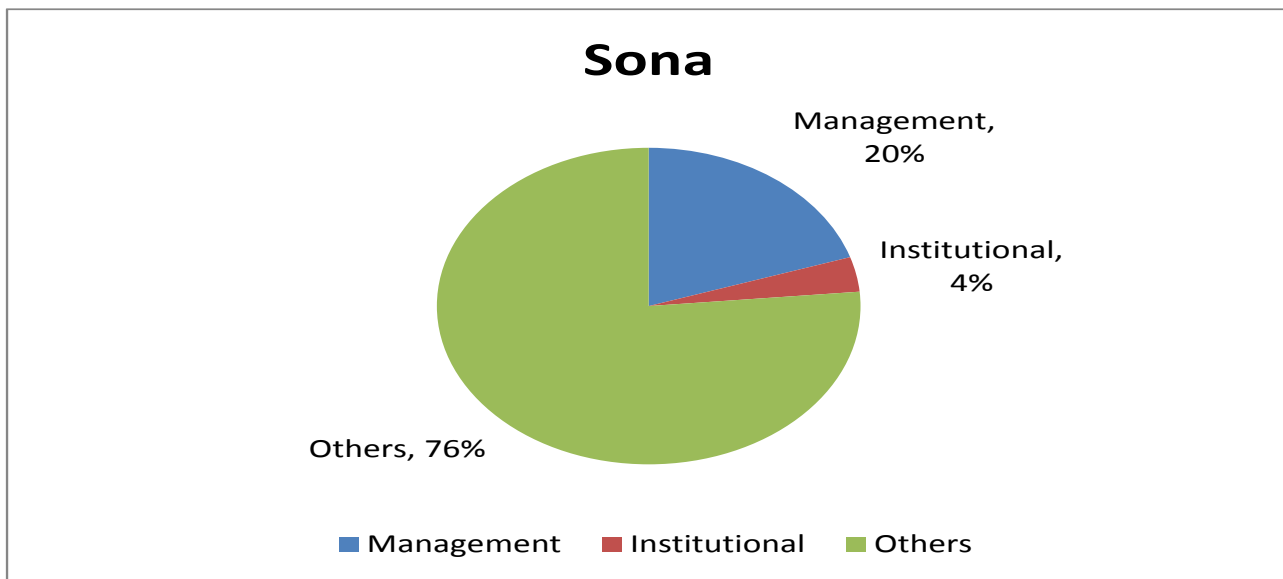
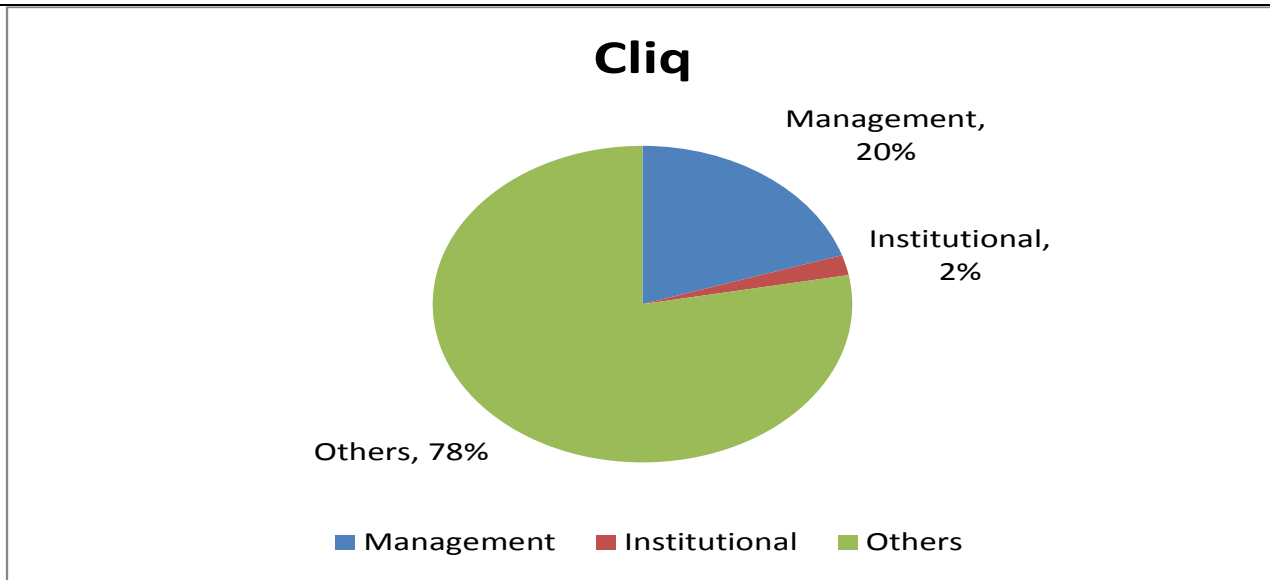
Figure #2: SPAC's Net Trust Per Share by Maturity

SPAC	(A)		(B)		(C)	=(A)+(B)+(C)	Upside (%)	Listing Date	Maturity Date	Days Left	Years Left	Return pa
	Price	Factored in interest earn	Interest Earn	Tax rate on interest earned (10%)	Other Expenses (~1%)							
Reach	0.60	0.781	0.070	-0.007	-0.008	0.766	29%	15-Aug-14	14-Aug-17	978	2.68	10.7%
Cliq	0.62	0.742	0.067	-0.007	-0.007	0.728	17%	10-Apr-13	9-Apr-16	486	1.33	13.1%
Sona	0.40	0.495	0.045	-0.004	-0.005	0.485	21%	30-Jul-13	29-Jul-16	597	1.64	13.0%
Hibiscus	0.98							25-Jul-11	24-Jul-14			

Source: HLIB

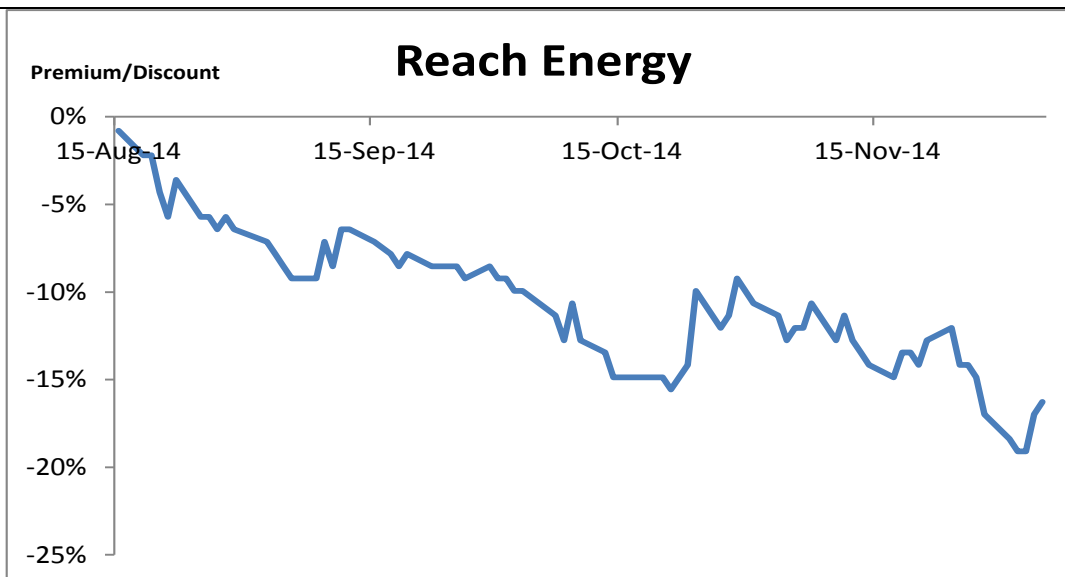
Note: We have assumed i) interest earned based on 3.2% pa., ii) 10% tax rate on interest earned and iii) other expenses ~1%.

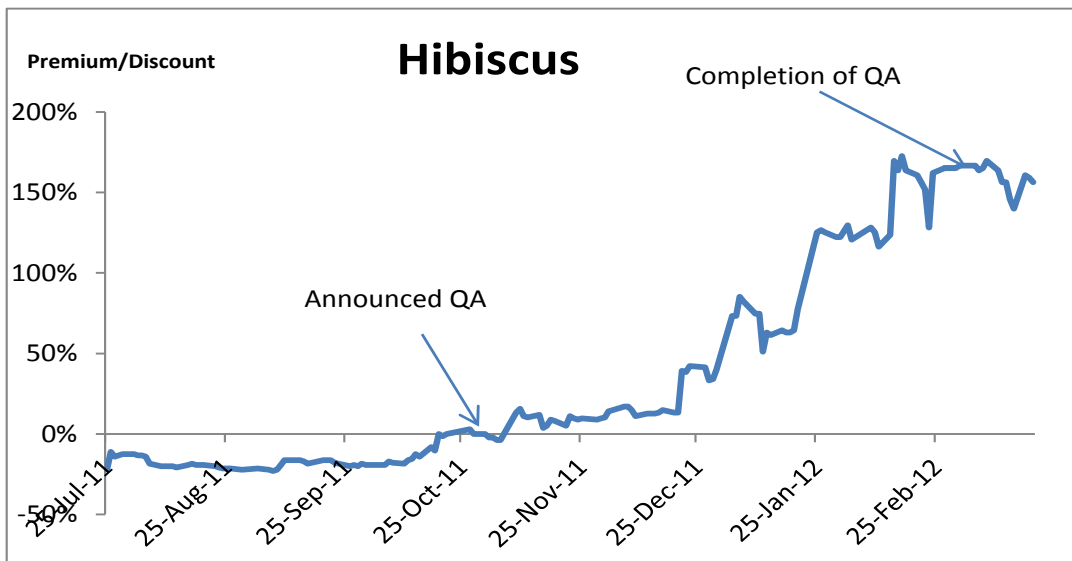
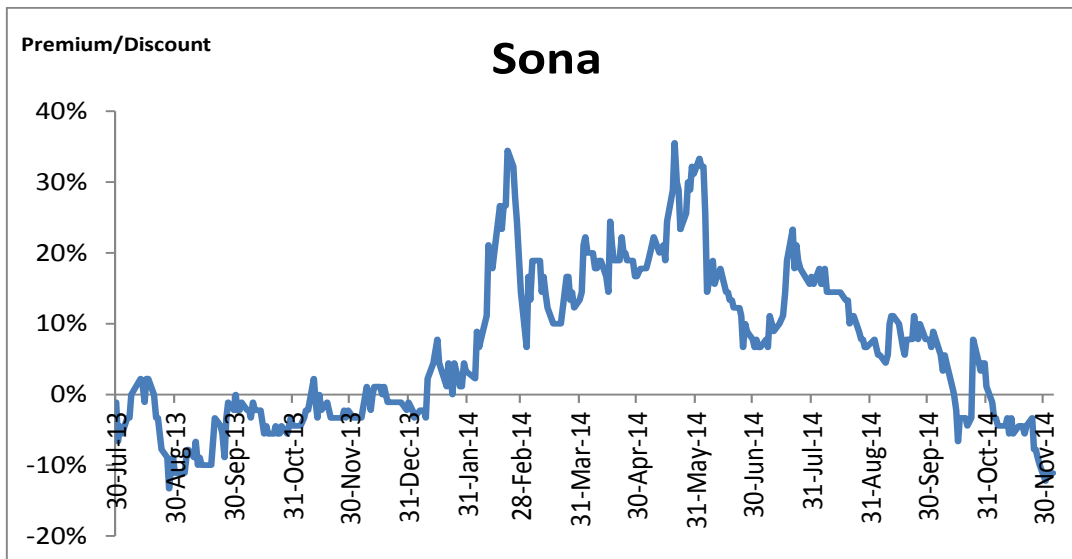
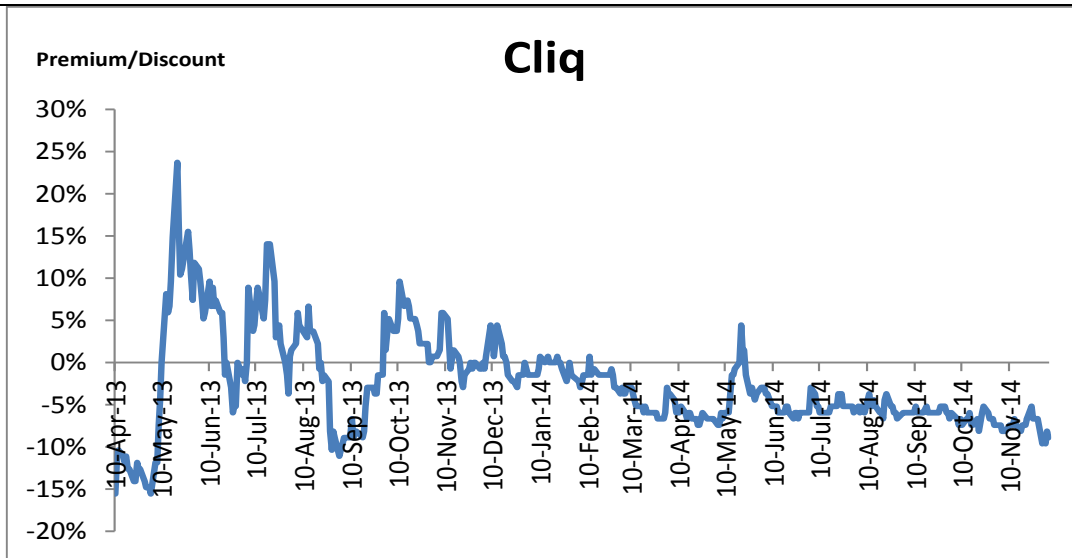
Figure #3: SPAC's shareholding



Source: HLIB

Figure #4: SPAC's share price to intrinsic cash value (IPO)





Source: HLIB

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BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
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