

# Arc Energy NL (ARQ)

## A strong profit result

**Increased oil prices (A\$54.62/bbl vs A\$40.33) and production levels (686.7mmbbls vs 490.2mmbbls) generated an increase of 83% in revenue, with an 86% increase in operating profit, and a 94% increase in net profit after tax of A\$16.3m (vs A\$8.4m Dec 03 half).**

### Key forecasts

	FY03A	FY04A	FY05F	FY06F	FY07F
EBITDA (A\$m)	18.0	40.4	59.4	52.2	44.8
Reported net profit (A\$m)	9.07	20.1	32.9	28.2	23.8
Adjusted net profit (A\$m) <sup>1</sup>	9.07	20.1	32.9	28.2	23.8
Normalised EPS (c) <sup>2</sup>	5.53	10.8	17.0	14.6	12.3
Normalised EPS growth (%)	7022.6	94.3	58.4	-14.2	-15.6
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Normalised PE (x)	36.2	18.6	11.7	13.7	16.2
EV/EBITDA (x)	21.9	9.18	5.14	4.68	4.16
Price/net oper. CF (x)	26.6	9.60	8.72	9.87	11.5
ROIC (%)	34.4	47.8	56.5	63.8	79.8

Source: Company data, ABN AMRO Morgans forecasts

year to Jun, fully diluted

1. Post-goodwill amortisation and pre-exceptional items

2. Pre-goodwill amortisation and exceptional items

### Exploration, development, increased production

Increased production from the 50%-owned Hovea/Eremia oil fields (up 11%) and the 33.1%-owned Jingemia oil field, as well as the increased equity in Jingemia (up from 21.1% from 12 October) contributed to increased oil production of 686,703 barrels of oil (490,220 December 2003 half). Gas sales were also stronger (1.71 PJ vs 0.65 PJ). Oil production was up 40% and costs were up 80%, reflecting increased unit production costs. However, this was offset by higher oil prices, which averaged A\$54.62 per bbl, compared with A\$40.33 in the December 2003 half.

### The benefits of a strong oil price

The increased oil production and higher price generated revenue of A\$49.4m (A\$26.9m pcp), with EBITDA of A\$30.0m (A\$16.0m previously) reflecting cash flow from operations of A\$30.3m (A\$16.3m pcp). Unit D&A charges were higher, and oil production was up 40%, with total D&A charges up 72% at A\$16.1m (A\$8.9m pcp). The tax rate remained marginally above 30%. Net profit after tax was A\$16.38m (A\$8.45m pcp), or 8.2c per share. No dividend was declared. Arc Energy (ARQ) reported net cash of A\$20m at 31 December 2004.

### IFRS - what it might mean

A more rigorous 'impairment test' could result in additional writedowns, and it is likely that recognition of 'restoration costs' will increase depreciation charges. The proposed tax sharing agreement transactions will be treated as equity transactions, and retained earnings and intercompany balances will be affected. The current treatment of exploration and evaluation expenditure is broadly in line with the requirements under IFRS. The sales contracts for oil and gas and the associated currency hedges are also likely to prove 'complying hedges' with no implications for accounting treatment.

### Important disclosures regarding companies that are the subject of this report and an explanation of recommendations and volatility can be found at the end of this document.

Priced at close of business 25 February 2005. Use of ▲ ▼ indicates that the line item has changed by at least 10%.

## Hold

**Important:** The above recommendation has been made for shorter-term investors and may not suit your individual investment requirements. The recommendation structure is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISOR**

## High Volatility

Absolute performance

Neutral

Market relative to region

Equities N Cash N Bonds N

Asset allocation

Oil & Gas

Australia

Price

A\$2.00

Target price

A\$2.20 ▲

Market capitalisation

A\$386.48m (US\$302.89m)

Avg (12mth) daily turnover

A\$0.85m (US\$0.64m)

Reuters

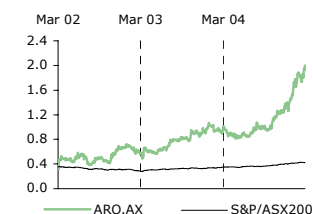
ARQ.AX

ARQ50228

### Price performance

	(1M)	(3M)	(12M)
Price (A\$)	1.87	1.32	0.93
Absolute %	7.0	51.5	115.1
Rel market %	5.0	43.2	73.5
Rel sector %	-1.4	48.1	91.7

Source: Bloomberg



Source: Bloomberg

52-week range: 2.03-0.81

S&P/ASX200: 4130.50

BBG AP Oil & Gas: 243.57

### Analysts

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## ARC ENERGY NL: KEY FINANCIAL DATA

### Income statement

A\$m	FY03A	FY04A	FY05F	FY06F	FY07F
Revenue	34.9	67.5	96.8	88.6	78.9
Cost of sales	-17.0	-27.1	-37.5	-36.3	-34.1
Operating costs	n/a	n/a	n/a	n/a	n/a
<b>EBITDA</b>	<b>18.0</b>	<b>40.4</b>	<b>59.4</b>	<b>52.2</b>	<b>44.8</b>
DD&A (ex gw)	-3.35	-10.1	-11.4	-10.9	-9.91
<b>EBITA</b>	<b>14.6</b>	<b>30.2</b>	<b>48.0</b>	<b>41.3</b>	<b>34.9</b>
Goodwill amort (pre-EBIT)	0.00	0.00	0.00	0.00	0.00
<b>EBIT</b>	<b>14.6</b>	<b>30.2</b>	<b>48.0</b>	<b>41.3</b>	<b>34.9</b>
Net interest	-0.72	-0.28	-0.98	-0.93	-0.88
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported PTP</b>	<b>13.9</b>	<b>30.0</b>	<b>47.0</b>	<b>40.3</b>	<b>34.0</b>
Taxation	-4.83	-9.88	-14.1	-12.1	-10.2
Minority interests	0.00	0.00	0.00	0.00	0.00
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported net profit</b>	<b>9.07</b>	<b>20.1</b>	<b>32.9</b>	<b>28.2</b>	<b>23.8</b>
Exceptionals (total)	0.00	0.00	0.00	0.00	0.00
<b>Adjusted net profit</b>	<b>9.07</b>	<b>20.1</b>	<b>32.9</b>	<b>28.2</b>	<b>23.8</b>

Source: Company data, ABN AMRO Morgans forecasts

year to Jun

### Balance sheet

A\$m	FY03A	FY04A	FY05F	FY06F	FY07F
Cash and liq assets (1)	4.00	15.8	81.2	142.4	200.1
Other current assets	14.9	9.39	9.39	9.39	9.39
Tangible fixed assets	30.0	53.7	39.6	24.9	9.23
Intang assets (incl gw)	0.00	0.00	0.00	0.00	0.00
Oth non-curr assets	9.11	22.6	22.6	22.6	22.6
<b>Total assets</b>	<b>58.0</b>	<b>101.6</b>	<b>152.8</b>	<b>199.3</b>	<b>241.4</b>
Short term debt (2)	10.0	0.00	0.00	0.00	0.00
Trade & oth current liab	3.53	10.6	10.6	10.6	10.6
Long term debt (3)	1.40	0.00	0.00	0.00	0.00
Oth non-current liab	6.16	15.7	15.7	15.7	15.7
<b>Total liabilities</b>	<b>21.1</b>	<b>26.3</b>	<b>26.3</b>	<b>26.3</b>	<b>26.3</b>
Total equity (incl min)	36.9	75.3	126.5	173.0	215.1
<b>Total liab &amp; sh equity</b>	<b>58.0</b>	<b>101.6</b>	<b>152.8</b>	<b>199.3</b>	<b>241.4</b>
Net debt (2+3-1)	7.40	-15.8	-81.2	-142.4	-200.1

Source: Company data, ABN AMRO Morgans forecasts

year ended Jun

### Cash flow statement

A\$m	FY03A	FY04A	FY05F	FY06F	FY07F
EBITDA	18.0	40.4	59.4	52.2	44.8
Change in working capital	-0.07	8.70	0.00	0.00	0.00
Net interest (pd) / rec	-0.72	-0.28	-0.98	-0.93	-0.88
Taxes paid	-4.83	-9.88	-14.1	-12.1	-10.2
Other oper cash items	0.00	0.00	0.00	0.00	0.00
<b>Cash flow from ops (1)</b>	<b>12.3</b>	<b>38.9</b>	<b>44.3</b>	<b>39.2</b>	<b>33.7</b>
Capex (2)	0.00	0.00	0.00	0.00	0.00
Disposals/(acquisitions)	-17.6	-27.5	9.29	10.3	12.3
Other investing cash flow	0.00	-6.54	-6.54	-6.54	-6.54
<b>Cash flow from invest (3)</b>	<b>-17.6</b>	<b>-34.0</b>	<b>2.75</b>	<b>3.75</b>	<b>5.75</b>
Incr / (decr) in equity	2.88	18.3	18.3	18.3	18.3
Incr / (decr) in debt	3.70	-11.4	0.00	0.00	0.00
Ordinary dividend paid	0.00	0.00	0.00	0.00	0.00
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	-0.12	0.00	0.00	0.00	0.00
<b>Cash flow from fin (5)</b>	<b>6.46</b>	<b>6.87</b>	<b>18.3</b>	<b>18.3</b>	<b>18.3</b>
Forex & disc ops (6)	-0.27	0.03	0.00	0.00	0.00
<b>Inc/(decr) cash (1+3+5+6)</b>	<b>0.90</b>	<b>11.8</b>	<b>65.3</b>	<b>61.2</b>	<b>57.8</b>
Equity FCF (1+2+4)	12.3	38.9	44.3	39.2	33.7

Lines in bold can be derived from the immediately preceding lines.

year to Jun

Source: Company data, ABN AMRO Morgans forecasts

## ARC ENERGY NL: PERFORMANCE AND VALUATION

Standard ratios											
Arc Energy NL	Australian Worldwide Exploration			Roc Oil Company							
Performance	FY03A	FY04A	FY05F	FY06F	FY07F	FY05F	FY06F	FY07F	FY04F	FY05F	FY06F
Sales growth (%)	151.4	146.7	45.9	-9.14	-11.6	195.7	298.7	155.9	-33.2	-99.3	60196.3
EBITDA growth (%)	472.8	124.9	47.0	-12.1	-14.1	n/a	562.2	181.2	-58.8	n/a	n/a
EBIT growth (%)	1660.4	107.0	58.6	-14.0	-15.4	n/a	1640.3	214.1	n/a	1264.3	n/a
Normalised EPS growth (%)	7022.6	94.3	58.4	-14.2	-15.6	n/a	653.2	219.6	73.2	167.1	n/a
EBITDA margin (%)	69.6	63.5	64.0	61.9	60.2	44.1	73.2	80.5	26.2	-5343.7	77.9
EBIT margin (%)	56.7	47.6	51.7	49.0	46.9	9.91	43.3	53.1	-2.76	-5443.7	51.2
Net profit margin (%)	35.2	31.6	35.4	33.5	32.0	14.1	28.7	36.0	-62.4	18053.2	28.5
Return on avg assets (%)	20.3	25.4	26.4	16.4	11.1	0.44	6.16	16.5	-9.56	14.7	10.7
Return on avg equity (%)	30.1	35.8	32.6	18.9	12.3	1.39	9.07	24.4	-11.4	17.1	13.6
ROIC (%)	34.4	47.8	56.5	63.8	79.8	0.88	10.4	25.7	-0.49	-5.98	23.2
ROIC - WACC (%)	25.6	39.0	47.7	55.0	71.1	-7.33	2.21	17.5	-10.7	-16.2	13.0
				<i>year to Jun</i>			<i>year to Jun</i>			<i>year to Dec</i>	
Valuation											
EV/sales (x)	15.3	5.83	3.29	2.90	2.50	23.3	6.36	1.82	6.59	989.6	1.16
EV/EBITDA (x)	21.9	9.18	5.14	4.68	4.16	52.9	8.69	2.26	25.2	n/m	1.49
EV/EBITDA @ tgt price (x)	24.1	10.1	5.79	5.42	5.02	62.7	10.2	2.78	36.9	n/m	2.43
EV/EBIT (x)	27.0	12.3	6.36	5.91	5.34	235.4	14.7	3.43	n/m	n/m	2.27
EV/invested capital (x)	8.89	6.23	6.74	7.97	12.5	2.01	1.72	1.58	1.50	1.07	0.86
Price/book value (x)	8.88	4.96	3.06	2.23	1.80	1.99	1.81	1.42	1.29	1.07	0.93
Normalised PE (x)	36.2	18.6	11.7	13.7	16.2	157.1	20.9	6.52	n/m	n/m	5.83
Norm PE @tgt price (x)	39.8	20.5	12.9	15.1	17.8	185.3	24.6	7.70	n/m	n/m	7.90
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Dividend Franking (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
				<i>year to Jun</i>			<i>year to Jun</i>			<i>year to Dec</i>	
Per share data					Solvency						
FY03A	FY04A	FY05F	FY06F	FY07F	FY03A	FY04A	FY05F	FY06F	FY07F		
Tot adj dil sh, ave (m)	163.9	186.9	193.2	193.2	193.2	Net debt to equity (%)	20.0	-21.0	-64.2	-82.3	-93.0
Reported EPS (c)	5.53	10.8	17.0	14.6	12.3	Net debt to tot ass (%)	12.7	-15.6	-53.1	-71.4	-82.9
Normalised EPS (c)	5.53	10.8	17.0	14.6	12.3	Net debt to EBITDA (%)	41.2	-39.2	-136.7	-272.7	-446.5
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00	Current ratio (x)	1.39	2.39	8.58	14.4	19.8
Equity FCF per share (c)	7.53	20.8	22.9	20.3	17.5	Operating CF int cov (x)	24.9	175.9	60.6	56.1	50.7
Book value per sh (c)	22.5	40.3	65.4	89.5	111.3	Dividend cover (x)	0.00	0.00	0.00	0.00	0.00
			<i>year to Jun</i>							<i>year to Jun</i>	

Source: Company data, ABN AMRO Morgans forecasts

## RESEARCH TEAM

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For stocks which do not fit neatly into a sector paradigm, we show a target price and an absolute recommendation based on the implied upside/downside. A Buy/Sell requires upside/downside of 15% or more; an Add/Reduce requires upside/downside of between 5% and 15%; a Hold implies less than 5% upside/downside. Given the volatility of share prices and our predisposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 6 to 12 months.

The target price is the level the stock should currently trade at if the market accepted the analyst's view of the stock, provided that the necessary catalysts are in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value the target price will differ from 'fair' value.

For large-cap stocks where there is a clearly defined, broadly-based sector universe our primary recommendation is relative to the sector universe.

Each stock has been assigned a Volatility Rating to assist in assessing the risk of the security. The rating measures the volatility of the security's daily closing price data over the previous year relative to other stocks included in either the S&P/ASX200 Index (large caps) or the Small Ordinaries Index (small caps) of which it is a member. This rating is a quantitative (objective) measure provided as an additional resource and is independent of the qualitative research process undertaken by our research analysts.

A rating of Low indicates very little movement in price over the previous year (Coefficient of Variation < 4 for small caps or < 5 for large caps). A Moderate rating implies average price movement over the previous year (Coefficient of Variation of 9 - 21 for small caps or 7.25 - 15 for large caps). A High rating implies significant price movement over the past year (Coefficient of Variation greater than 25 for small caps or 35 for large caps).

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Mentioned companies: **ARQ.AX, AWE.AX, ROC.AX**

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