

Cash Flow is King?

Red Rock Resources (RRR) today announced an agreement to acquire a 20% working interest (14.4% net revenue) in near term producing well (LM20) on the **Shoats Creek** Field in Louisiana for a modest consideration of US\$200K (\$120K cash + \$80K / 4.5% 3 year note). Along with the previously announced acquisition of wells LM21 and LM22 that will cost around \$500K to \$600K to earn into (20% WI, 14.4% NRI), this puts the Group on track to generate cash flow from three producing wells in the coming months, where the project and geological risks are very low.

Despite current low oil prices, according to our estimated risked asset valuation model, with oil at just under \$20 per barrel, production at 10% below the level projected by the operator Shoats Creek Development Inc, LM20 would still have a positive NPV. On an operating basis, the Operator is aiming at a cost per barrel on LM20 in the range of \$8 to \$12 per barrel over time. Most of the capital required to finance the new oil wells by RRR will be funded from proceeds (£426K) gained from the recent successful disposal of shares in ASX listed Star Striker, along with consideration tranches due from Colombia this calendar year (\$225K Jan, \$225K May/June).

Although the Shoats Creek wells are only asset accretive by an NPV of \$0.24m (£0.17m), their real contribution will be to provide low risk short term cash flow to finance the retention and exploitation of other Group assets. At an oil price of \$25 per barrel, we estimate a cash flow net to RRR of around \$76K per quarter could be generated in the first two years after initial capital expenditure (circa \$670K) is repaid. Cash flow could rise to \$136K per quarter if oil returns to \$50 per barrel.

Along with further potential sales of **Star Striker** shares, and developments at Shoats Creek, other imminent newsflow is likely to come from **Kenya**, where the outcome of a court hearing is anticipated on 27 January, which could result in the gold exploration licences being restored to Red Rock and the re-commencing of the process to seek farm-in partners.

In this research note we have updated our estimate valuations of other interests, several of which are awaiting an asset realisation event for RRR to lock in value, for example a potential IPO of **Elephant Oil**, sale or relisting of **Jupiter Mines**, sale of **Greenland** iron ore interests or securing of farm-in partners for the **Ivory Coast** gold projects.

A total estimated valuation of £11.1m has been computed, which is almost the same as our previous estimate of £11.06m, although our target share price has moved up proportionally higher from 4.0p to 4.2p due to better than expected debt management. With new cash flow producing assets being added, reduced corporate overheads and a project portfolio with multiple asset realisation catalyst potential, the shares offer considerable upside from the current share price of 0.375p and ultra low market cap of £0.9m. We therefore continue to rate **Red Rock Resources Plc** as a 'Buy'.

BUY*

Price Target 4.2p# (1120% potential upside)

Price Data

Share Price:	0.375p
Shares in Issue:	241.4m
52 Week High/Low	0.195p/0.0175p

Profile

Market:	AIM - London
Sector:	Basic Resources
Ticker:	RRR.L
Weblink	rrrplc.com

Key Data

Market Cap:	£0.9m
Net Debt (est. Jan 16):	£30K
Est Net Asset Value:	£11.1m

Activities

Investment, exploration, development and mining of resource projects with a focus on oil, gold, along with manganese and iron ore.

Directors

Andrew Bell (Exec Chairman)
Michael Nott (Non-Ex)
Sam Quinn (Non-Ex)
Scott Kaintz (Non-Ex)

Main Shareholders > 4%

TD Direct Investing Nom'	10.5%
Barclayshare Nominees	10.1%
HSDL Nominees	6.9%
Daniel Sklan	4.3%

Est. Valuation Summary

	Jan'16	Oct'15
Colombia	£1.70m	£1.71m
Kenya	£3.63m	£3.39m
Ivory Coast	£0.25m	£0.25m
Greenland	£1.46m	£1.36m
Shoats Creek	£0.17m	n/a
Elephant Oil	£0.25m	£0.25m
Jupiter Mines	£3.48m	£3.72m
Star Striker	£0.20m	£0.47m

Exchange Rates: A\$/£2.07 / US\$/£1.43
(as at 9.00am 19/01/16)

#previous price target 4.0p (914% upside from 0.438p share price) - 01/05/15. - adjusted for 25 for 1 share consolidation

***Dowgate Capital Stockbrokers act as Broker to Red Rock Resources plc.**

VALUATION RATIONALE

Our sum-of-the parts valuation (Table 4) estimate is based upon the same methodology as applied in previous Dowgate Capital research notes, the most recent being published on 13 October 2015.

The valuation for Red Rock's **Colombian** assets has dropped slightly from £1.71m to £1.70m, benefitting from a stronger US\$ and a lower discounted cash flow factor, but impacted by a lower gold price which is reflected within the mining royalty consideration. Remaining outstanding payments owed to Red Rock come to US\$4.45m, of which the royalty element comprises US\$3m, spread over an estimated production period of 10 years. Our £1.70m estimated Colombian valuation includes an imminent payment tranche of US\$225,000 (undiscounted) which should be received within the next 30 days, including a further US\$225,000 payment due later this year, discounted by 6 months.

The **Kenya** gold exploration asset valuation remains unchanged in US\$ terms (US\$5.19m), but higher in sterling terms at £3.63m (£3.39m). The valuation estimate continues to be double risked, at the project level of 50%, along with a licence risk factor of 30%. The outcome of a court hearing due to take place on the 27 January 2016 in Kenya may enable us to reduce or eliminate the licence risk factor if a decision is made in Red Rock's favour to restore the licences.

For the **Ivory Coast**, our valuation remains unchanged at £0.25m for the gold exploration interests to reflect costs spent to date. Red Rock's 4.76% stake in **Elephant Oil** also remains unchanged at £0.25m.

A stronger US\$ has nudged up our valuation estimate for **Greenland** from £1.36m to £1.46m, which represents a heavily deflated number that is only 10% of the withdrawn offer price received for Red Rock's project stake in 2012 of US\$20.88m. The recent pick up in investment and mining activity in Greenland over the last 12 months provides encouragement going forward, despite the current resources bear market.

Red Rock's equity stake in private company **Jupiter Mines** and royalty interest in Mt Ida valuation estimate is reduced to £3.48m (£3.72m), due to slightly lower net assets reported by Jupiter in its recent accounts (to 31/08/15) and to our increased royalty interest risk factor from 75% to 80% to reflect weaker resource prices.

Since our last research note, Red Rock has taken advantage of an improved share price of ASX listed **Star Striker** Ltd to dispose of 52.3m shares to realise A\$0.87m (circa £0.43m) at an average price of 1.67c. The remaining 13m shares and 5.2m options (exercisable at 0.4c) are valued at the recent bid price of 2.4 cents to give a current asset value of A\$0.47m (£0.20m).

Although the new **Shoats Creek** oil project is more of a cash flow than asset play, for completeness we have calculated an NPV for the planned three well programme of US\$0.17m (Tables 1 to 3). This is based upon an oil price of \$25 per barrel, discount rate of 10%, an estimated net average daily production rate of 60 barrels for the first two years, dropping to an average 21 barrels in the next five years. We have applied a small development risk factor of 10% to the NPV figures for step out wells LM21 and LM22.

Since our last research note, £95K (US\$150K) of the original £175K YA Global Master SPV loan note has been repaid with cash, as opposed to being converted into shares near the prevailing share price¹. Although our estimated net asset value of £11.11m is only 0.4% more than previously calculated in October 2015 (£11.06m), the valuation per share is 5% higher at 4.2p (4.0p) due to the potential of fewer shares being issued in the future to repay a smaller convertible loan note. Given the cash flows anticipated from Colombia, Star Striker and potential producing fields at Shoats Creek in 2016, any remaining debt could be repaid with cash or the management may opt to convert into shares at a higher and less dilutive share price.

¹ Shares converted at 94% of the three lowest daily volume weighted average prices during 15 consecutive trading days following conversion.

SHOATS CREEK PRODUCTION AND VALUATION ANALYSIS

PROJECTED PRODUCTION PROFILE		Barrels of oil (Gross) Est. Annual Production		Combined 3-wells (Net) to Red Rock (20% Y1, 16.25% Y2 onwards)	
Year	Depletion Rate	LM20 Well	LM21 & LM22 Wells	Annual	Per Day (BOPD)
Y1	56.7%	49,275	98,550	29,565	82
Y2	76.2%	27,922	55,845	13,612	38
Y3	85%	21,270	42,541	10,369	29
Y4	85%	18,080	36,160	8,814	24
Y5	85%	15,368	30,736	7,492	21
Y6	85%	13,063	26,125	6,368	18
Y7	85%	11,103	22,207	5,413	15
Y8	85%	9,438	18,876	4,601	13
Y9	85%	8,022	16,044	3,911	11
Y10	85%	6,819	13,638	3,324	9
Y11	85%	5,796	11,592	2,826	8
Y12	85%	4,927	9,853	2,402	7
Total		191,083	382,165	98,696	

Table 1: Projected Production Profile – Source Dowgate Capital.
 NB1: Oil projections estimated at 10% below those projected by operator.

NPV SENSITIVITY ANALYSIS 10% discount rate, (Net) to Red Rock			
Oil Price per barrel	LM 20 Well (US\$,000)	LM 21/22 Well (US\$,000)	Total (US\$,000)
\$10	(155.8)	(327.3)	(483.1)
\$20	8.6	27.0	35.5
\$25	79.0	163.1	242.1
\$30	158.7	282.1	440.8
\$40	274.5	569.1	843.7
\$50	422.4	754.0	1,176.4
\$60	570.2	1,020.1	1,590.4

Table 2: NPV Sensitivity Analysis to varying oil prices. – Source Dowgate Capital.
 NB1: A 10% project risk has been applied to LM21/22.

CASH FLOW SENSITIVITY ANALYSIS			
Est. Per Quarter Net Cash Flow to Red Rock in first two years following capital expenditure payback			
Oil Price p/barrel	LM 20 Well (US\$,000)	LM 21/22 Well (US\$,000)	Total (US\$,000)
\$10	2.6	20.4	23.0
\$20	14.7	44.7	59.5
\$25	19.1	56.9	76.0
\$30	24.8	64.5	89.2
\$40	30.6	87.1	117.8
\$50	40.5	95.6	136.1
\$60	50.4	115.4	165.8

Table 3: Cash Flow Sensitivity Analysis to varying oil prices (per quarter). – Source Dowgate Capital.

Group Valuation Summary

Asset <i>A\$/£2.07 US\$/£1.43</i>	A\$ or US\$ Valuation	£ Valuation	Comments
Colombia	US\$2.44m	£1.70m	<i>Present value of future payments and estimated royalty - Previously \$2.61m (£1.71m).</i>
Kenya	US\$5.19m	£3.63m	<i>Double risked project value - Unchanged in US\$ (£3.39m).</i>
Ivory Coast	US\$0.37m	£0.25m	<i>Project cost to date - Unchanged.</i>
Greenland	US\$2.09m	£1.46m	<i>Risked potential sale value - Unchanged in US\$ (£1.36m).</i>
Shoats Creek	US\$0.24m	£0.17m	<i>N/A- new investment.</i>
Elephant Oil Limited	US\$0.37m	£0.25m	<i>Recent Investment, valued at cost.</i>
Jupiter Mines Ltd Equity Stake Mt Ida Royalty	A\$4.25m US\$2.04m	£2.05m £1.42m	<i>Previously A\$4.30m (£2.05m) equity stake and US\$2.55m (£1.67m) royalty value estimate.</i>
Star Striker Ltd	A\$0.47m	£0.20m	<i>ASX Market Value - Previously A\$0.90m (£0.47m), before sale of 52.3 shares to realise A\$0.87m proceeds</i>
15 Jan '16 Valuation		<i>(13 Oct '15 Valuation)</i>	
Sub Total		£11.14m	£11.11m
Net Debt		Net Debt (£30K)	<i>Net Debt (£50K)</i>
Total		£11.11m	£11.06m
Shares In Issue		241.4m	241.2m
Notional shares issued if remaining YA Global Master loan note converted into shares		20.0m (£80K)	38.8m (£175K)
Combined Shares in Issue <i>With cash proceeds added from any potential loan note conversion</i>		264.0m £11.19m	280.0m £11.23m
Price per share		4.2p	4.0p

Table 4: Group Valuation Summary.

NB1: Exchange rate used for research note on 13/10/15 was A\$/£2.10 & US\$/£1.53.

NB2: Target Price & Shares in Issue for 13/10/15 adjusted for 25/1 share consolidation that took place on 21/12/15.

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