October 7, 2020

BHP acquires Hess' 28% stake in Shenzi for US$505 million

Summary: On 5 October 2020, Hess announced the sale of its 28% stake in the Shenzi deepwater US Gulf of Mexico development to BHP for US$505 million. Shenzi is a mature subsalt, Miocene field operated by BHP that has been producing since March 2009. The deal includes Genghis Khan, which is the western flank of the main Shenzi structure and has been developed independently, but has since been unitized with Shenzi into a single economic unit. BHP will increase its stake to 72%, while Repsol retains its current 28%. The deal is expected to close in December with an effective date of 1 July 2020.

Given the maturity and production history of the asset, we consider this a low-risk transaction for both parties. Our NPV10 base-case valuation is US$387 million, equivalent to US$13.56/boe. The transaction price implies US$38,327 per flowing barrel based on the latest production data available. We believe the discount to the announced consideration is driven by our more conservative view on reserves.

Key Deal Metrics

Welligence reserves (MMboe)	Reported reserves (MMboe)	Welligence NPV10 (US$MM)	Consideration (US$MM)	Welligence price (US$/boe)	Price per flowing barrel (US$ per boe/d)
28.5	N/A*	387	505	13.56	38,327

NB. Effective date 1 Jul 2020, discount date 1 Jan 2020, discount rate 10%, long-term Brent price US$58/bbl (real) in our base-case.
*No reported reserves in deal announcements.

This is a strategic divestment for Hess, as it will reinvest the funds in its world-class Guyana portfolio, which underpins the company's growth outlook for many years to come. This focus was demonstrated when Hess elected not to take part in the Shenzi pumping project that was sanctioned earlier this year – see *Asset Description* for details. The value and reserves associated with this project were therefore excluded in this transaction.

For BHP, this is a tactical move, consolidating its ownership of the most important operated asset in its US Gulf of Mexico portfolio. The company's exploration holdings around the Shenzi TLP mean the project carries greater longer-term opportunity for it than for Hess.

Asset Description: Shenzi is a mature oil producer that is a core part of BHP's US Gulf of Mexico portfolio. Located in the southeast corner of the Green Canyon protraction area, it straddles five leases – GC 609, 610, 652, 653 and 654. It should be noted that the western flank of the Shenzi structure (GC 652) is also known as Genghis Khan and has been developed as a two-well tieback to the Marco Polo facility, independent of the main Shenzi accumulation.

Shenzi is one of several large, subsalt, Miocene fields in the area, alongside the likes of BP's Mad Dog and Atlantis (BHP is a partner in both) and Occidental's Marco Polo and K2 projects. First oil at Shenzi was achieved in March 2009, and oil output peaked at 144,495 bbl/d in October of the same year. It has largely been falling ever since.

The initial development

Shenzi was discovered by BHP Billiton in 2002 on GC 654. It was initially mooted as a tieback to Anadarko's nearby Marco Polo TLP, but eventually a standalone solution was selected as reserves grew during the appraisal program. Sanction of the US$4.4 billion project was taken in June 2006, and first oil followed less than three years later through a purpose-built 100,000 bbl/d TLP in 1,333m of water.

A total of 18 producer wells have been drilled over the life of the project to date. Production fell rapidly from its peak to settle at a five-year plateau of just under 100,000 bbl/d. During this period, BHP executed a steady program of infill drilling and brought water injection online in 2011 to provide pressure support. There has been minimal development activity since 2015.

Genghis Khan was discovered by Anadarko in April 2006 on GC 652, immediately to the west of Shenzi. Given it was clear they were a single accumulation, with most of the resource lying with Shenzi, it wasn't a surprise that the Shenzi partners acquired Genghis Khan in November 2006 for US$1.35 billion. Development of GC 652 was fast-tracked as a two-well tieback to Anadarko's (now Occidental) Marco Polo TLP – start-up was in October 2007.

Future development work

The next project will be the installation of subsea pumps to allow for greater recovery. BHP is also studying infill drilling options, but we consider those to offer little value.

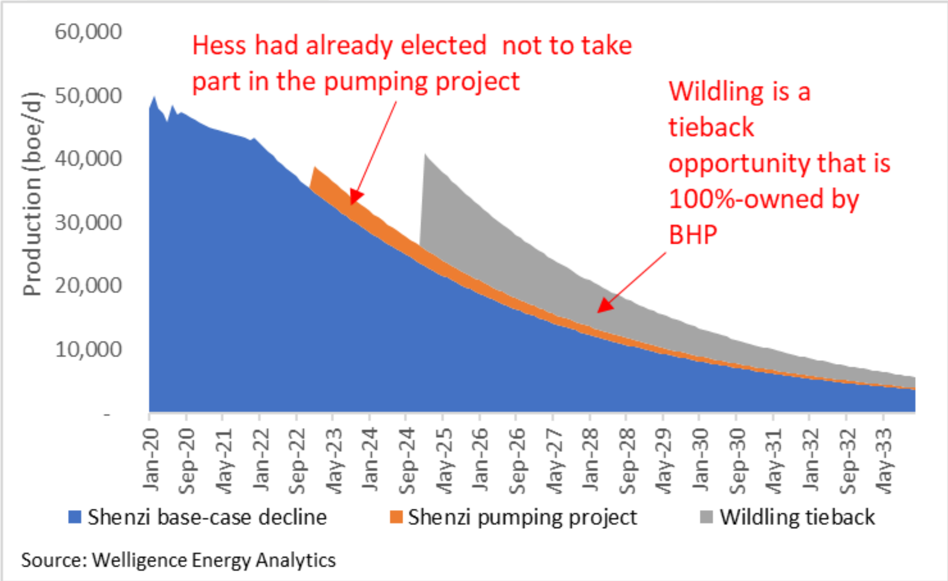
- **Pumping project:** Earlier this year, BHP sanctioned the *Shenzi Subsea Multi-Phase Pumping* project. This will allow for increased recovery from existing wells, with the operator anticipating an additional 4,000 bbl/d. We estimate the project will cost US$150 million. Note that Hess had elected not to take part in this project.

- **Infill drilling:** Contingent resource has been identified at Shenzi that could be developed through infill drilling – studies are ongoing. Using our current well cost estimate of US$150 million (includes the associated subsea cost) and EUR of 9 MMboe, our model indicates that each new well adds approximately US$50 million of value (gross) to the project.

- **Near-field exploration:** BHP has carried out an ocean bottom node survey across the Shenzi leases to identify exploration targets. Any discovery can be easily developed via the existing TLP, which is underutilized and has spare capacity.

  The company is also working up development plans for its wholly owned Wildling discovery, which lies to the northwest on GC 520 and GC 564. The initial phase will comprise two subsea wells, and more wells may follow depending on performance. First oil is expected over 2024/2025, with production of 15,000 bbl/d targeted.

The Shenzi project – production outlook

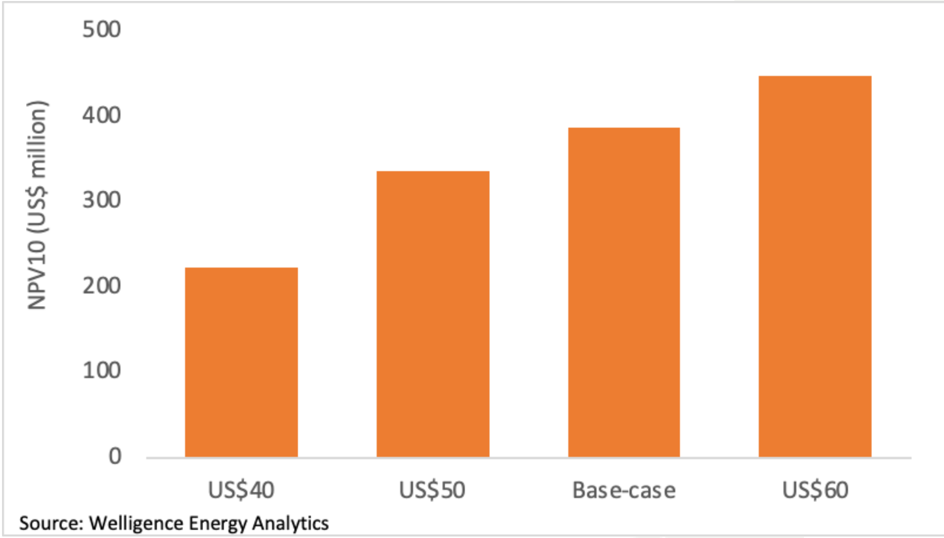


Source: Welligence Energy Analytics

Valuation: We value Hess's 28% stake of Shenzi at US$387 million (NPV10, US$58/bbl Brent real), a significant discount to the announced consideration of US$505 million. The difference is likely due to our more conservative view on reserves.

Our estimate of the net reserves transacted in this deal is 29 MMboe. This figure is underpinned by the well declines forecast by our machine learning algorithms. Neither buyer nor seller announced reserves, but the public figure available from BOEM is 37 MMboe which suggests that our outlook is more conservative. If we apply our US$13.56/boe transaction multiple to the difference, our valuation increases to US$497 million, effectively in line with the consideration.

Shenzi – base-case valuation sensitivity to Brent price



Source: Welligence Energy Analytics

Analysis: This is a case of strategic divestment meets tactical acquisition. For Hess, the company is monetizing its stake in Shenzi to support its investment obligations in Guyana. BHP is taking advantage to consolidate its ownership of an operated asset in which it has a long-term commitment.

This is the second deepwater asset deal in the US Gulf of Mexico since the March price collapse, following Beacon Offshore's acquisition of Shenandoah from LLOG in July.

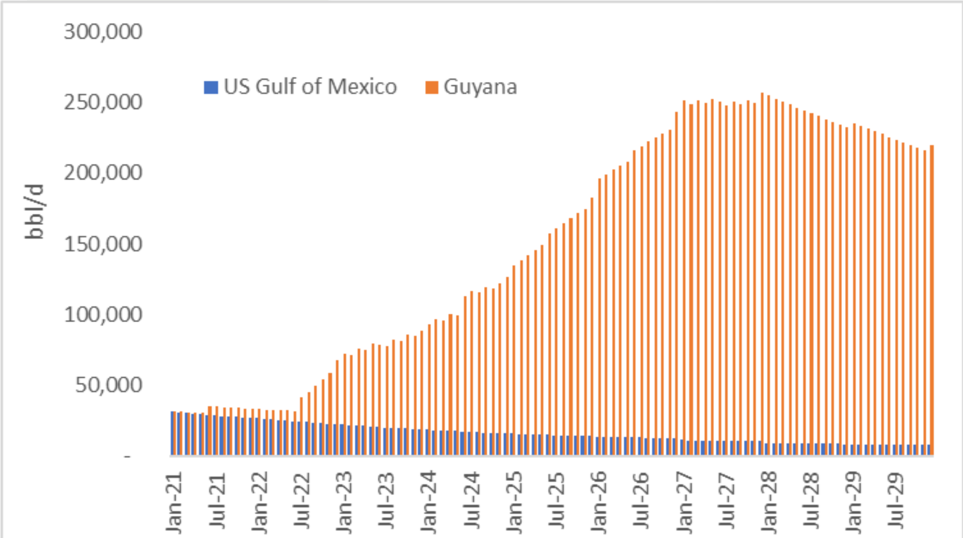
- **BHP:** The US Gulf of Mexico is core to the company. It has a strong subsalt Miocene position in the southeastern area of Green Canyon, with exposure to some of the best projects. This acquisition consolidates its ownership and control at its most important operated asset.

  Although we see only modest remaining development potential at Shenzi itself, the underutilized infrastructure is in line to host the BHP-operated satellite find, Wildling. Production of these barrels through the TLP can in turn extend the economic life of the Shenzi reservoir itself.

- **Hess:** This divestment has a straightforward driver – funding Guyana. Hess has a 30% position in the ExxonMobil-led Stabroek asset, a truly world-class project that is being aggressively developed. The block has yielded 18 discoveries since 2015 and over 8 bnboe of resource. The scale of resource, attractive fiscal terms, and remaining exploration potential make this the priority project for all the partners.

  First oil from Stabroek was in December 2019 through the 120,000 bbl/d Liza Destiny FPSO. The second phase (220,000 bbl/d Liza Unity FPSO) is on track for start-up in 2022, and third phase was sanctioned last month. At least two further phases are expected. We estimate Hess' investment commitment from 2021 to 2025 at US$4.7 billion. With internally generated cash flow squeezed by the price crash, this sale helps ensure it can meet its spend commitments in Guyana and reduces the risk of a forced farm-down.

Hess oil production – growing Guyana vs. declining US Gulf of Mexico



Sources: Welligence Energy Analytics

This and the recent Shenandoah transaction shows that deals are being done in the current market environment. Given its commitments in Guyana, additional sales by Hess cannot be ruled out. There are other opportunities as potential sellers look to relieve balance sheet pressures (e.g. Occidental) and/or offload non-core assets (e.g. ExxonMobil). We published our take on Fieldwood Energy's portfolio, given the company has filed for its second Chapter 11 filing in the last two years.

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