

Hyperion Exploration Corp. (HYX C\$0.89, TSX-V)

Hyperion reports strong 3Q11 financial results; Cardium drilling results above our type curve; maintaining Buy recommendation and C\$1.80 target

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Hyperion Exploration Corp.

Rating	Buy-Above-average Risk
Target	C\$1.80
Symbol	HYX
Exchange	TSX-V
Sector	Oil & Gas
Price	C\$0.89
Total return	102%
52-week range	C\$0.47-2.40
Shares O/S	54.2m
Market cap	C\$48.2m
Net debt	C\$15.6m
Enterprise value	C\$63.9m
Year-end	Dec-31
Tot prod'n 2011E	950boe/d
2012E	1,650boe/d
CFPS (dil) 2011E	C\$0.17
2012E	C\$0.33
EPS (dil) 2011E	-C\$0.08
2012E	C\$0.06

Source: Desjardins Capital Markets



Highlights

Strong 3Q11 financial results. Hyperion reported average 3Q11 production of 1,050boe/d (vs our 875boe/d and 943boe/d in 2Q11) and cash flow of C\$0.05/share (vs our estimate and the Street consensus of C\$0.03/share). The cash flow beat was primarily a result of stronger production and a higher oil weighting, which more than offset higher royalties and softer realized crude oil prices.

Reiterating 2011 production guidance; financially well positioned to pursue an aggressive 2012 drilling program.

Hyperion reiterated its 2011 average production guidance of 950boe/d and its exit rate of 1,500boe/d. The company plans to announce its 2012 capital budget and provide preliminary production guidance in January. We currently forecast a C\$20m program resulting in average production of 1,650boe/d for the year.

We believe the company remains financially well positioned to pursue an aggressive 2012 drilling program. Hyperion reported that it exited 3Q11 with net debt of C\$0.5m (vs our C\$2.6m estimate) and its C\$24m bank line remaining undrawn. We estimate that Hyperion will have ~C\$14.1m remaining undrawn on its current bank line at year-end 2012 and believe that the company could receive a ~C\$3-6m increase in its bank line following its next scheduled review in January.

Strong Cardium drilling results at Garrington and Buck Lake. Hyperion announced 30-day IP rates for three Cardium horizontal wells: the 8-27 at Garrington (282boe/d, 89% oil & liquids), the 9-27 at Garrington (498boe/d, 89% oil & liquids), and the 4-16 at Buck Lake (374boe/d, 58% oil & liquids). The drilling results compare favourably with our 'low case' Cardium type curve of 150boe/d (30-day IP rate), which we have used for 85% of the company's drilling locations in our risked resource-build NAV.

Valuation

Our estimate of Hyperion's base NAV, reflecting 2010 reserves and the 1H11 Garrington acquisition, is C\$1.51/share (after tax). Including the risked upside from the company's Cardium developments, the sum is C\$1.85/share. Hyperion currently trades at ~0.5x this combined NAV estimate.

Hyperion currently trades at an estimated 2012 EV/boe/d of C\$38,700, an estimated 2012 EV/DACF multiple of 3.5x and a P/NAV (after tax) multiple of 0.6x, compared with its peer group average of C\$60,900, 4.8x and 1.0x, respectively. The shares trade at a significant discount, which is indicative of the fact that the company is in the early stages of its Cardium development and is still consolidating and growing its asset base.

Recommendation

We view Hyperion's 3Q11 financial results positively, given that the company posted strong production that beat our forecast and reported cash flow above the Street consensus. We are also encouraged by the company's strong Cardium drilling results that came in well above our type curve. Given its current discount valuation, we believe Hyperion offers investors an inexpensive way to gain 'high-torque' Cardium light oil resource play exposure from a junior producer. We also believe that Hyperion is financially well positioned to pursue an aggressive 2012 drilling program, and that investors' attention will remain focused on the company's ability to execute its drilling program while continuing to post Cardium drilling results that are in line with the industry type curve. We maintain our Buy-Above-average Risk rating and 12-month target of C\$1.80. The target price gives a ~1.0x weighting to our risked resource-build NAV and implies a 2012 EV/DACF multiple of ~6.0x.

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Event

Hyperion released its 3Q11 financial results and provided an operational update.

Implication

Strong 3Q11 financial results. Hyperion reported average 3Q11 production of 1,050boe/d (54.5% oil & liquids), which was above the company's 2Q11 production of 943boe/d (46.9% oil & liquids) and our estimate of 875boe/d (42.9% oil & liquids). The production beat was attributable to well optimizations and better-than-expected Cardium drilling results.

The company posted 3Q11 cash flow of C\$2.5m (vs our C\$1.5m), or C\$0.05/diluted share, which was above our estimate and the Street consensus of C\$0.03/share. The cash flow beat (relative to our forecast) was primarily a result of stronger production and the higher oil weighting, which more than offset higher royalties (C\$12.05/boe vs our C\$7.55/boe) and softer realized crude oil prices (C\$84.68/bbl vs our C\$86.59/bbl). Hyperion also reported elevated operating costs of C\$12.79/boe (vs our C\$12.20/boe and C\$10.82/boe in 2Q11), though this was more than offset by lower-than-expected transportation costs (C\$1.59/boe vs our C\$2.25/boe).

Summary of HYP's 3Q11 results					
Year-end Dec-31	3Q11	2Q11	Chg (%)	3Q11E	Vs est (%)
Financial highlights					
Cash flow (C\$m)	2.5	2.2	14	1.5	66
CFPS diluted (C\$)	0.05	0.05	-7	0.03	66
Earnings (C\$m)	-2.4	-0.1	NA	-0.4	NA
EPS diluted (C\$)	-0.04	0.00	NA	-0.01	NA
Capital expenditures (C\$m)*	11.4	1.9	499	12.5	-9
Net debt (C\$m)	0.5	-8.4	NA	2.6	-82
Net debt/cash flow (x)	0.0	-1.0		0.4	
Operating highlights					
Oil & liquids (bbl/d)	572	442	29	375	53
Natural gas (mmcf/d)	2.9	3.0	-5	3.0	-4
Total production (boe/d)	1,050	943	11	875	20
Natural gas (%)	45.5	53.1	-14	57.1	-20
Growth per share (yoy%)	-8.0	6.3		-23.3	
Prices					
Realized oil & liquids price (C\$/bbl)	84.68	87.86	-4	86.59	-2
Realized natural gas price (C\$/mmbtu)	3.89	4.23	-8	3.85	1
Netbacks					
Revenue (C\$/boe)	57.05	55.20	3	50.30	13
Hedging (C\$/boe)	0.00	0.00	NA	0.00	NA
Transportation (C\$/boe)	-1.59	-1.38	16	-2.25	-29
Royalties (C\$/boe)	-12.05	-8.11	49	-7.55	60
Operating costs (C\$/boe)	-12.79	-10.82	18	-12.20	5
Operating netback (C\$/boe)	30.61	34.89	-12	28.31	8
G&A (C\$/boe)	-5.09	-9.40	-46	-9.94	-49
Interest (C\$/boe)	-0.24	-0.36	-34	0.08	NA
Current tax	0.00	0.00	NA	0.00	NA
Cash flow netback (C\$/boe)	25.28	25.14	1	18.45	37
* Includes acquisitions and dispositions					
Source: Desjardins Capital Markets, company reports					

Reiterating 2011 production guidance; financially well positioned to pursue an aggressive 2012 drilling program. Hyperion reiterated its 2011 average production guidance of 950boe/d (52% oil & liquids) and its exit rate of 1,500boe/d (67% oil & liquids). The company plans to announce its 2012 capital budget and provide preliminary production guidance in January 2012. We currently forecast a C\$20m program resulting in average production of 1,650boe/d for the year.

Revised estimates						
Year-end Dec-31	2011			2012		
	Old	New	Chg (%)	Old	New	Chg (%)
Oil & liquids (bbl/d)	500	500	0	1,200	1,200	0
Natural gas (mmcf/d)	2.7	2.7	0	2.7	2.7	0
Total production (boe/d)	950	950	0	1,650	1,650	0
Cash flow from operations (C\$m)	8.0	7.9	-2	19.7	17.9	-9
CFPS basic (C\$)	0.17	0.17	-2	0.36	0.33	-9
CFPS diluted (C\$)	0.17	0.17	-2	0.36	0.33	-9
Capital expenditures (C\$m)*	60.0	59.3	-1	20.0	20.0	0
Net debt (C\$m)	14.2	13.6	-5	14.5	15.6	8
Trailing net debt/cash flow (x)	1.8	1.7	-3	0.7	0.9	18

* Includes acquisitions
 Source: Desjardins Capital Markets, company reports

We believe the company remains financially well positioned to pursue an aggressive 2012 drilling program. Hyperion reported that it exited 3Q11 with net debt of C\$0.5m (vs our C\$2.6m estimate), including a C\$5.8m working capital deficit, which was largely offset by a C\$5.3m cash balance; the company's C\$24m bank line remained undrawn at the end of 3Q11. Based upon our current assumptions, we estimate that Hyperion will have ~C\$14.1m remaining undrawn on its current bank line at year-end 2012. We also believe that based upon the current crude oil pricing environment and the company's active 2H11 drilling program, that Hyperion could receive a ~C\$3–6m increase in its bank line following its next scheduled review in January 2012.

2011 and 2012 bank debt estimate		
Year-end Dec-31 (C\$m)	3Q11	
Current cash balance	5.3	
Bank line drawn	0.0	
Working capital deficiency	5.8	
Net debt	0.5	
	4Q11	2012
Cash flow from operations	2.4	17.9
Capital expenditures	-15.5	-20.0
Net cash flow change	-13.1	-2.1
Bank line drawn*	7.8	9.9
Undrawn bank line	16.2	14.1
Net debt	13.6	15.6

* Estimate assumes no change in working capital deficiency or bank line capacity
 Source: Desjardins Capital Markets, company reports

Strong Cardium drilling results at Garrington and Buck Lake. Hyperion drilled and completed three (2.6 net) Cardium horizontal wells in 3Q11, with two net wells at Garrington and one (0.6 net) well at Buck Lake. The company has drilled an additional two net wells at Pembina in 4Q11 and plans to drill another well (0.6 net) at Buck Lake in late December or early January.

- Garrington.** The company's 08-27-033-03W5 (100% WI) Cardium horizontal well, which was completed with 20 stages of 20-tonne foam water fracs, achieved a 30-day IP rate of 282boe/d (89% oil & liquids). Hyperion's 09-27-033-03W5 (100% WI) Cardium horizontal well, completed using 20 stages of 20-tonne slick water fracs, achieved a 30-day IP rate of 498boe/d (89% oil & liquids). The Garrington drilling results compare very favourably with the company's internally generated Garrington Cardium type curve of 194boe/d (30-day IP rate) and our 'low case' Cardium type curve of 150boe/d (30-day IP rate), which we have used for 85% of the company's drilling locations in our risked resource-build NAV. Based upon the more favourable results from slick water fracs, the company plans to use them to complete its seven remaining Garrington Cardium drilling locations.
- Buck Lake.** Hyperion's 04-16-045-05W5 Cardium horizontal well (60% WI), which was completed using 18 stages of 20-tonne slick water fracs, achieved a 30-day IP rate of 374boe/d (58% oil & liquids), which compares favourably with the company's internally generated Buck Lake Cardium type curve of 176boe/d (30-day IP rate) and our 'low case'

Cardium type curve. The company plans to spud a second well in the area (05-16-045-05W5; 60% WI) in late December or early January.

- Pembina.** The company recently drilled two Cardium horizontal wells (100% WI) in the area (04-24-050-10W5 and 05-24-050-10W5), which were completed with 20 stages of 20-tonne slick water fracs. The wells are currently being equipped and are expected to be brought onstream in mid-December. Two of Hyperion's wells that came onstream in late March are still producing at rates above the company's Pembina Cardium type curve (30-day IP rate of 275boe/d, production of ~104boe/d after eight months).

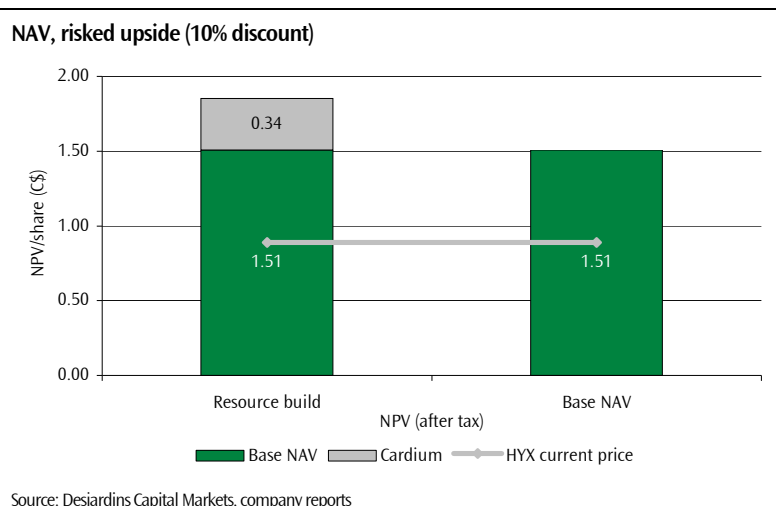
2H11 Cardium drilling program

Operating area	Well location	Working interest (%)	Status	Completion	30-day IP rate (bbl/d)
Garrington	08-27-033-03W5	100	Producing	20 stages of 20-tonne foam water fracs	282 (89% oil & liquids)
Garrington	09-27-033-03W5	100	Producing	20 stages of 20-tonne slick water fracs	498 (89% oil & liquids)
Buck Lake	04-16-045-05W5	60	Testing	18 stages of 20-tonne slick water fracs	374 (58% oil & liquids)
Pembina	04-24-050-10W5	100	Currently completing/equipping	20 stages of 20-tonne slick water fracs	NA
Pembina	05-24-050-10W5	100	Currently completing/equipping	20 stages of 20-tonne slick water fracs	NA
Buck Lake	05-16-045-05W5	60	Spud in late December or early January	NA	NA

Source: Desjardins Capital Markets, company reports

Valuation

Our estimate of Hyperion's base NAV, reflecting 2010 reserves and the 1H11 Garrington acquisition, is C\$1.51/share (after tax). Including the risked upside from the company's Cardium developments, the sum is C\$1.85/share. Hyperion currently trades at ~0.5x this combined NAV estimate.



NAV, risked upside (10% discount)

	NPV (C\$/share)		Resources/ reserves (mmboe)
	Before tax	After tax	
Risked upside potential			
Cardium	0.49	0.34	2.4
Base NAV	1.62	1.51	2.6
Sum	2.11	1.85	

Source: Desjardins Capital Markets, company reports

Hyperion currently trades at an estimated 2012 EV/boe/d of C\$38,700, an estimated 2012 EV/DACF multiple of 3.5x and a P/NAV (after tax) multiple of 0.6x, compared with its peer group average of C\$60,900, 4.8x and 1.0x, respectively. The shares trade at a significant discount, which is indicative of the fact that the company is in the early stages of its Cardium development and is still consolidating and growing its asset base.

Hyperion Exploration Corp.				
Summary				
Symbol	HYX		Valuation	2009 2010 2011E 2012E
Exchange	TSX-V		P/CF (x)	-1.5 -55.6 6.8 2.7
Rating	Buy-Above-average Risk		EV/DACF (x)	3.9 -206.2 9.6 3.5
Target price (C\$)	1.80		EV/production (C\$000/boe/d)	-84.5 457.0 81.0 38.7
Share price 28-Nov-11 (C\$)	0.89		EV/total reserves (C\$/boe)	-33.00 31.46 NA NA
Total return (%)	102		Aft-tax Bef-tax	
			Blowdown NAV (10% disc) (C\$)	1.51 1.62
			P/NAV (x)	0.6 0.5
Average daily production	2009	2010	2011E	2012E
Oil & liquids (bbl/d)	7	47	500	1,200
Natural gas (mmcf/d)	0.0	0.4	2.7	2.7
Total production (boe/d)	9	112	950	1,650
Natural gas (%)	19.2	58.2	47.4	27.3
Growth per share (yoy%)		-55.1	40.2	48.0
Commodity price assumptions	2009	2010	2011E	2012E
WTI (US\$/bbl)	61.95	79.50	93.50	92.50
Edmonton Par (C\$/bbl)	64.78	76.78	90.75	87.50
Western Canada Select (C\$/bbl)	61.71	66.47	75.00	74.00
Henry Hub (US\$/mmbtu)	4.16	4.40	4.25	4.75
AECO (C\$/mcf)	3.97	4.00	3.85	4.35
Exchange (US\$/C\$)	0.88	0.97	1.01	1.00
Realized oil & liquids price (C\$/bbl)	54.60	72.33	82.09	78.80
Realized natural gas price (C\$/mmbtu)	3.67	4.02	4.13	4.57
Financial statistics	2009	2010	2011E	2012E
Cash flow from operations (C\$m)	-0.2	-0.2	7.9	17.9
CFPS basic (C\$)	-0.71	-0.03	0.17	0.33
CFPS diluted (C\$)	-0.71	-0.03	0.17	0.33
Earnings (C\$m)	-0.2	-1.7	-3.8	3.0
EPS basic (C\$)	-0.83	-0.22	-0.08	0.06
EPS diluted (C\$)	-0.83	-0.22	-0.08	0.06
Per boe values	2009	2010	2011E	2012E
Revenue (C\$/boe)	46.53	47.11	55.37	65.02
Hedging (C\$/boe)	0.00	0.00	0.00	-0.07
Transportation (C\$/boe)	0.00	-1.62	-1.63	-2.00
Royalties (C\$/boe)	-3.05	-6.16	-10.32	-14.92
Operating costs (C\$/boe)	-31.23	-14.57	-11.43	-12.50
Operating netback (C\$/boe)	12.25	24.76	32.00	35.53
G&A (C\$/boe)	-71.66	-30.83	-7.59	-5.30
Interest (C\$/boe)	0.00	0.00	-0.32	-0.55
Cash flow netback (C\$/boe)	-59.40	-6.07	24.08	29.68
Reserves and capital efficiencies	2009	2010	2011E	2012E
Proven (mmboe)	0.0	1.3		
Probable (mmboe)	0.0	0.4		
Total proven & probable (2P) (mmboe)	0.0	1.6		
	2010	3-year		
FD&A—proven, incl FDC (C\$/boe)	29.89	NA		
Recycle ratio—proven (x)	NA	NA		
RLI—proven (years)	8.9			
FD&A—2P, incl FDC (C\$/boe)	23.43	NA		
Recycle ratio—2P (x)	NA	NA		
RLI—2P (years)	11.5			
Reserve evaluator	McDaniel & Associates			
Management and directors				
Trevor Spagrud (President & CEO, Director)	Rod Maxwell (Chairman)			
Larry Hammond (COO)	Dan O'Neil (Director)			
Doug Bailey (CFO)	Greg Turnbull (Director)			
Tim Gee (VP, Engineering)	Greg Bay (Director)			
Ryan Heath (VP Land & Business Development)				
Steve Horth (Manager, Exploration)				
Recent events				
Oct-10: Completed C\$28.75m equity offering (19.2m common shares, 9.6m warrants); C\$3m flow-through financing (1.8m common shares)				
Nov-10: Acquired Cardium assets at Pembina, Niton and Chip Lake (530boe/d)				
Mar-11: Acquired Garrington Cardium and Buck Lake assets (C\$26.5m, 350boe/d)				
Mar-11: Completed C\$35m equity offering (22m subscription receipts, 1.1m flow-through common)				
Jun-11: Announced increased credit facility of C\$24m, from C\$13m				
Note: All numbers shown in C\$ unless otherwise stated; reserves shown are company interest, gross of royalties				
Source: Desjardins Capital Markets, company reports				
	2009	2010	2011E	2012E
Capital structure and spending	2009	2010	2011E	2012E
Basic shares O/S wtd avg (m)	0.3	7.6	46.1	54.2
Diluted shares O/S wtd avg (m)	0.3	7.6	46.1	54.2
Market capitalization (C\$m)	0.3	56.3	63.4	48.2
Net debt (C\$m)	-1.0	-5.1	13.6	15.6
Enterprise value (C\$m)	-0.7	51.2	77.0	63.9
Capital expenditures (C\$m)	0.0	35.5	59.3	20.0
Capex/cash flow (x)	0.0	-143.0	7.5	1.1
Trailing net debt/cash flow (x)	5.4	20.7	1.7	0.9
Bank lines (C\$m)	0.0	0.0	24.0	24.0
Net debt as a % of bank lines (%)			56.5	65.2
Dividends or distributions	2009	2010	2011E	2012E
Dividends or distributions per share/unit (C\$)	0.00	0.00	0.00	0.00
Cash flow payout ratio (%)				
Yield (%)				
Annual sensitivities (CFPS diluted)	2009	2010	2011E	2012E
Oil WTI \pm US\$1.00/bbl (%)			1.9	1.9
Gas \pm C\$0.25/mcf (%)			2.5	1.1
Oil \pm 100 bbl/d (%)			25.6	9.8
Gas \pm 1.0 mmcf/d (%)			6.7	2.9
Selected quarterly estimates	1Q11	2Q11	3Q11	4Q11E
Commodity price assumptions				
WTI (US\$/bbl)	94.26	102.58	89.59	87.57
Henry Hub (US\$/mmbtu)	4.20	4.38	4.05	4.35
Realized oil & liquids price (C\$/bbl)	80.92	87.86	84.68	76.86
Realized natural gas price (C\$/mmbtu)	4.07	4.23	3.89	4.30
Financial and operating statistics				
Oil & liquids (bbl/d)	277	442	572	704
Natural gas (mmcf/d)	2.1	3.0	2.9	2.8
Total production (boe/d)	633	943	1,050	1,168
Natural gas (%)	56.2	53.1	45.5	39.8
Cash flow from operations (C\$m)	0.8	2.2	2.5	2.4
CFPS basic (C\$)	0.03	0.05	0.05	0.04
CFPS diluted (C\$)	0.03	0.05	0.05	0.04
Earnings (C\$m)	-1.06	-0.12	-2.40	-0.19
EPS basic (C\$)	-0.03	0.00	-0.04	0.00
EPS diluted (C\$)	-0.03	0.00	-0.04	0.00
Capital expenditures (C\$m)	30.4	1.9	11.4	15.5
Net debt (C\$m)	-8.3	-8.4	0.5	13.6
Properties				
Area	Detail			
Pembina	Cardium, 11.5 net sections—9.4 net hz locations			
Garrington	Cardium, 3.25 net sections—7.0 net hz locations			
	Glauconite, Elkton (liquids-rich natural gas)			
Buck Lake	Cardium, 3.65 net sections—14.4 net hz locations			
Niton	Cardium, 12 net sections—4.0 net hz locations			
	Wilrich (liquids-rich natural gas)			
Paradise-Boundary Lake, BC	Charlie Lake oil			
	Montney & Gething oil/Halfway, Kiskatinaw & Baldonnel natural gas			
Pricing catalysts				
Potential for multiple expansion as more Cardium oil well results are released				
2011 reserves report—conservative 2010 bookings position Hyperion for strong reserves growth				
Downspacing and secondary recovery in the Cardium				
Horizontal multi-stage frac development potential at Paradise				
Additional accretive acquisitions				

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Distribution of ratings					
Rating category	Desjardins rating	Desjardins coverage universe (# of stocks)	% distribution	Desjardins Investment Banking (# of stocks)	% distribution
Buy	Top Pick/Buy	108	79	36	72
Hold	Hold	25	19	12	24
Sell	Sell	3	2	2	4
Total		136	100	50	100

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STOCK RATING SYSTEM

Top Pick

Desjardins' best investment ideas – stocks that offer the best risk/reward ratio and that are expected to significantly outperform their respective peer group* over a 12-month period

Buy

Stocks that are expected to outperform their respective peer group* over a 12-month period

Hold

Stocks that are expected to perform in line with their respective peer group* over a 12-month period

Sell

Stocks that are expected to underperform their respective peer group* over a 12-month period

Not Rated

Stock is being covered exclusively on an informational basis

RISK QUALIFIERS

Average Risk

Risk represented by the stock is in line with its peer group* in terms of volatility, liquidity and earnings predictability

Above-average Risk

Risk represented by the stock is greater than that of its peer group* in terms of volatility, liquidity and earnings predictability

Speculative

High degree of risk represented by the stock, marked by an exceptionally low level of predictability

* Peer group refers to all of the companies that an analyst has under coverage and does not necessarily correspond to what would typically be considered an industry group. Where an analyst's coverage universe is such that 'relative' performance against a 'peer group' is not meaningful, the analyst will benchmark the rating against the most appropriate market index

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