RAPER CAPITAL

Antony Craven Walker
Chairman, Board of Directors
Serica Energy Plc
48 George Street
London W1U 7DY
United Kingdom

January 12, 2023

Dear Mr Craven Walker,

Entities I manage are beneficially interested in 1,300,000 shares of Serica Energy Plc (hereafter 'Serica' or 'the Company'). I am writing today to express my unmitigated disgust with the contemplated acquisition of Tailwind Energy (the 'Proposed Combination')[1]. In my two decades in the markets, I cannot recall a transaction so completely irredeemable as to fail even the most perfunctory of governance norms; nor one so totally at odds with the wishes of its shareholders. **The Proposed Combination is flawed in its conception, its structure, and its purported outcome; and it fails the most basic of merger tests, offering a far inferior return to either the maintenance of the *status quo*, or a number of other readily-available alternative transactions**. Just five months ago, our Board refused to even contemplate a *bona fide* combination with Kistos Plc – a deal delivering 425p in value per share, along with control of the pro-forma entity – claiming that the bid 'significantly undervalues Serica.'[2] Yet now this same Board is recommending a transaction in which we will grant 29% of the pro-forma share capital to a third party at a price of 278p – all whilst surrendering *de facto* control of the Company, to boot! In what warped, alternate reality could any fiduciary consider this an acceptable outcome, much less trumpet such an exchange as a 'win' for the suffering masses?

To add insult to injury, the Proposed Combination is being rushed through in a matter of weeks, accompanied by a storm of misinformation, in a transparent attempt to shove the transaction down shareholders' throats before potential competing bids from third parties are allowed to surface in the fullness of time.

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[1] See 'Proposed Acquisition of Tailwind Energy', December 20, 2022. https://www.serica-energy.com/downloads/releases/221220_Volcano_RNS_vFinal1.pdf
[2] See 'Statement re. possible offer', July 13, 2022. https://www.serica-energy.com/downloads/releases/SQZ%20-%20Statement%20re%20possible%20offer%20130722.pdf

There is no doubt that should it be consummated, the Proposed Combination would destroy hundreds of millions of pounds of shareholder value at a stroke, and irrevocably deliver this value into the hands of Mercuria – solely to entrench Serica management who, absent the Chairman, own next to none of the Company themselves.

The problems with the Proposed Combination are extensive, but what follows is an attempt to categorize its primary failings.

The Proposed Combination immediately incinerates shareholder value

Recent company materials have been focused on the supposedly overwhelming 'strategic rationale' for the Proposed Combination, but zero attempt has been made to justify the ludicrous price being paid for Tailwind. I have my own reservations about the acquisition rationale, but putting that aside, paying a reasonable price must be the *sine qua non* of any transaction – let alone one like this that totally guts the company of its cash balance. In this regard, the price being paid for Tailwind, and the form of the consideration, is so blatantly detestable as to render any discussion of the strategic merits immediately moot. **The total consideration for the Proposed Combination of 703 GBPmm represents a multiple of ~$20/barrel of 2P reserves, with 52% of the purchase price being settled with Serica shares. But our Serica shares trade – referencing the acquisition mark of 278p – at an implied EV/2P reserves of ~$6/barrel, a 70% discount to the price being paid!**[3] And because much of the consideration is being gifted in equity rather than cash, the benefit of any subsequent, theoretical rerating of the combined equity pass overwhelmingly to the seller, rather than pre-existing Serica shareholders.

On a flowing production basis, too, the proposed terms beggar belief. Standalone Serica is producing 26k boe/d, and has guided to 25k boe/d for the next three years; meanwhile the implied Tailwind production over the same period is 18-20k boe/d.[4] And yet management has deigned to pay >700mm GBP, gifting half the consideration in shares whose Enterprise Value today, on a higher go-forward production base, is barely 300mm GBP. **As such this transaction immediately and irrevocably destroys at least 300mm GBP of extant shareholder value**. It is as if management, in possession of a pan and desiring an omelet, proceeded to exchange a Rolex for a carton of eggs, only to then claim, 'Well, we did need the eggs.'

The Proposed Combination surrenders de facto control, without a control premium

Management has contended that bringing Mercuria into the fold, as a 25% shareholder, will be of benefit to minority shareholders, parading around a 'Standstill Agreement' as some small

[3] Calculated using January 1, 2022 2P Reserves at Tailwind and Serica, respectively, as disclosed by management; 278p Serica share price; and 1.2 GBP/USD FX rate.
[4] Derived from footnotes on p.31-2, in 'Serica's Acquisition of Tailwind – Publication of Circular', January 9, 2022. https://www.serica-energy.com/downloads/presentations/090123_Serica%20Circular%20Presentation.pdf

consolation meant to assuage our concerns.[5] Standstill Agreement or not, **Mercuria becomes the *de facto* controlling shareholder of the company, holding the power to reject any and all subsequent merger proposals that may not meet its own narrow interests**. Since Mercuria maintains valuable marketing and hedging relationships that exist far beyond the scope of Serica's producing assets, minority shareholders should rightly be concerned they are at risk of being subordinated; Serica equity would obviously trade at a structural discount, *in perpetuity*, to reflect this new reality. Why would management underwrite an effective change of control transaction via the issuance of so much equity without extracting a premium for control? And why issue any equity at all when your own equity currency trades at nary 1.5x earnings, ex cash?

<u>Management's portrayal of the Proposed Combination as 'accretive' is highly deceptive</u>

In the recent presentation pitching the deal, management made various statements regarding pro-forma operational metrics (such as 2P reserves, production, operating cash flow etc), claiming, variously, that on all these metrics, *on a per share basis*, the Proposed Combination would be 14-23% accretive.[6] Such a portrayal is deceptive at best, and a complete insult to the intelligence of Serica shareholders. **Per share metrics do NOT dictate underlying corporate value if the entity in question is massively net cash (as Serica is here, with 60% of the market cap in cash, today), and if the entity being acquired is levered (as is the case for Tailwind).** As management obviously knows, almost any deal can be made to look 'accretive' if the acquiror is simply swapping cash for a levered but cashflow/net income positive business. Resultingly, it appears management is simply attempting to confuse shareholders in a blatant attempt to ram this derisory deal down our throats.

In order to truly assess the accretion (or decretion) of this transaction to existing shareholders, we would need to consider *both* changes in net cash pre- and post-transaction; *and* also changes in extant share count. Serica management, in their misleading portrayal, has included only the latter while completely ignoring the former. But, if this transaction were consummated**, Serica shareholders would be exchanging 336mm in net cash – that is, the difference between pre- and post-deal net cash – or 90p per extant share, for about 10p in extra earnings per share (even if we were to believe Management's projections).**[7] Simple math implies this is about a **nine-year payback on the acquisition – a horrendously expensive multiple, not least when one's own equity is trading at under two times free cash flow ex cash**!

<u>Superior alternatives to this transaction exist, offering far more upside and less risk</u>

The principal consideration of any transformational merger must always be, 'is this the best deal available to shareholders given all of the alternatives?' In this regard, the Tailwind deal fails at every hurdle. There are likely innumerable superior alternatives to this abominable transaction, but two immediately come to mind and seem clear alternatives:

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[5] See ibid., p.10.
[6] See 'Proposed Acquisition of Tailwind', January 9, 2023, p. 3.
[7] Change in net cash simply year-end disclosed net cash at Serica (460mm) less pro-forma net cash as disclosed by management (124mm). 10p in extra EPS based on management guidance, see ibid., p.3.

- ***A merger with Kistos Plc***: in August last year, management inexplicably refused to engage with Kistos in a merger of equals transaction, that would have delivered 425p in total value to Serica shareholders at the time and a controlling share in an enlarged, UK continental shelf gas champion. Even today, if the combination were to be consummated on the exact same terms, Serica shareholders would receive 380p in total consideration and crucially 213p in cash.[8] Such an outcome would constitute a **41% premium to where SQZ equity currently trades, and a 37% premium to the level at which our management agreed to sell 29% of the pro-forma equity via the Proposed Combination**. Moreover it would not create a *de facto* new controlling shareholder (leaving extant Serica shareholders as the major bloc in the new entity), and it would allow all shareholders to derisk their investment by cashing out the excess balance sheet cash. Given it would provide the combined entity with larger scale, a diversity of operating assets, and a platform for future acquisitive growth, **it would also fulfill essentially all of the rationale given for the Proposed Combination.** One wonders why management was so against doing the right thing and pursuing this deal…
- ***An accelerated tender for a large portion of the company***: instead of squandering our excess cash on the Proposed Combination, management could use 350mm of the 460mm net cash – leaving more than enough of a counter-cyclical buffer within the company - to retire 43% of the shares at 300p. **This would improve all the same per-share metrics favored by management to the tune of 75% - *5-7 times* the amount of accretion promised under the Proposed Combination, with zero execution or combination risk**. Moreover, such a move would instantaneously remove the gargantuan 'trapped cash' discount embedded in Serica shares and likely see residual shares trade up in excess of 40%.

<u>Management's portrayal of Serica's standalone earnings power is massively sandbagged</u>

As misleading as the 'accretion' math is, management's portrayal of our Company's standalone earnings power is almost as bad and designed simply to allow an easy comparison to the post-transaction entity. In its January 9th RNS, management claims that 2023E standalone EPS would be – referencing 250 GBp/therm gas prices, \$80/barrel Brent, 25k boe/d and <\$20/barrel opex – about 85p at mid-point. These numbers look laughably too low. Consider that in 1H'22, Serica saw gas prices average 136 GBp/therm; higher oil prices; higher but similar production rates (26,600 boe/d); and slightly lower costs (\$16/barrel opex).[9] Despite gas prices being almost half of management assumptions here and with most other KPIs similar enough, Serica earned 42p diluted EPS, or basically the same annual EPS as management is now modeling. Whilst 250 GBp/therm may be too aggressive an assumption, if this is truly the model case I believe **standalone Serica would earn closer to 120p in EPS than 80p, or almost 50% higher than what management is presenting**.[10] The only plausible explanation for this 'oversight' is a

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[8] Keeping the deal terms identical to Kistos' latest proposal, but adjusting for Kistos' lower stock price to today's level of 425p per share.
[9] See 'Results for the six months ended 30 June 2022', September 27, 2022. https://www.serica-energy.com/downloads/presentations/090123_Serica%20Circular%20Presentation.pdf
[10] Raper Capital estimates based on historical filings, management disclosures re 2023 production and costs.

desire to make the deal seem, even on an incomplete basis, at least marginally accretive, in the hopes of hood-winking shareholders into voting for the deal.

<u>There are next to no operational synergies resulting from this transaction</u>

Even if we were to accept that the price paid were somehow acceptable, management's claim that there is a strong strategic rationale to the deal remains highly questionable. Both companies are located in the North Sea, but thereafter the industrial logic for the deal falls away. **Tailwind's assets are entirely in different fields, with zero contiguity to Serica's operations; are largely oil, not gas; and are constrained by existing marketing relationships with Mercuria and its parent**. Management portrays the acquisition as one of 'achieving scale' and becoming a 'top 10 independent' in the UK. But why? The reach for scale is not laudable, in and of itself, unless it is executed on additive terms. Serica today is not sub-scale; has very low extant extraction costs; and has consistently managed to maintain 2P Reserves as well as grow production in recent years. Even if we were to accept the logic of getting bigger for its own sake – which I do not – why are North Sea assets, subject as they are to the UK's new punitive tax regime, even up for consideration (especially after management said they would look at other geographies)? And if we must deal in the North Sea then why are we picking the deal where we get 45% less for our shares and lose control, rather than the Kistos deal that remains available on far superior terms?

In closing, let me say, Mr Craven Walker, as a meaningful shareholder yourself, I am shocked that you have given your imprimatur as Chairman to support this deal; and I am outraged you have allowed this transaction to be presented to shareholders as 'accretive' in such a highly misleading manner. I must inform you that I intend to vote **AGAINST** the share issuance motion needed to proceed with the Proposed Combination, and I will encourage all other shareholders to join me in its rejection. Subsequent to the shareholder vote, and assuming a repudiation of this heinous deal, I would expect the Board to both immediately consider all available strategic alternatives, and offer to reconstitute the Board with a majority of new members who more accurately reflect the wishes of the shareholder base.

I look forward to seeing this deal consigned to the dustbin of history where it belongs, and then getting fair value for our shares one way or another.

Yours sincerely,

Jeremy Raper