

8 January 2014

Oil & Gas
FTSE All Share

Parkmead Group

Crossfire: Parkmead takes another shot at Athena

On 30 December 2013, Parkmead announced that it signed an agreement with EWE Vertrieb GmbH ("EWE") to acquire a 20% interest in the producing Athena oil field, trebling Parkmead's interest in the field to 30%. It was also noted that a work programme is now planned for 2014 that will increase production from the field. As a result we are increasing our fiscal 2014 production forecast for the company from 895 boe/d (77% oil production) to 1,935 boe/d (89% oil production). We are now forecasting a profit of £6.5mn in fiscal 2014, which compares to our prior estimate of a loss of £6.2mn. We are increasing our target price to 374p/share, it was 327p/share prior to placing it under review upon the announcement of this transaction.

- Material and immediate contribution to cash flow:** Based on our estimates, production from Athena has an extremely high value per barrel of oil produced because i) Parkmead acquired tax losses when it acquired Lochard Energy that essentially shelter the company's 30% interest in the field from the UK North Sea's 62% tax rate ii) we assume that the field produces until the end of the 1H 2016 (no change), thus the typical time value of money effects are limited and iii) apart from the modest costs of replacing a dual ESP pump the field's capex has essentially been paid for. We are confident in our operating cost estimates due to the high level of disclosure from Lochard Energy prior to its acquisition by Parkmead. We expect operating costs to average \$32.88/bbl before the field is shut-in. As a result, we expect the value per barrel of oil produced to equate to circa \$39.90/bbl. We expect that the field will generate operating cash flow of \$30.8mn net to Parkmead in fiscal 2014 and \$49.1mn in the following year (after the Gemini royalty is paid in respect of the 10% of the field acquired via Lochard Energy). Thus the field can be expected to quickly pay for itself and self fund capital expenditure.
- Premium Company:** Parkmead's relentless pace of development continues to exceed our aggressive expectations. We believe that production growth in the political safety of the UK North Sea in the hands of a proven management team (that founded, grew and sold Dana Petroleum for over US\$3 billion) creates a robust argument favouring a premium valuation for the company relative to our 374 p/share estimate of the company's fair value. We reiterate our Buy recommendation.

Price	248p
Price target	374p
12m high/low	248p /164p
Market cap.	£171m
Net cash	£5m
Enterprise value	£166m
Free float	63%
Avg. daily volume	180k
Shares in issue	69.1m
Company code	PMG.L

Next news	n/a
Confidence in estimates	Medium
Expected movement in estimates	◀▶

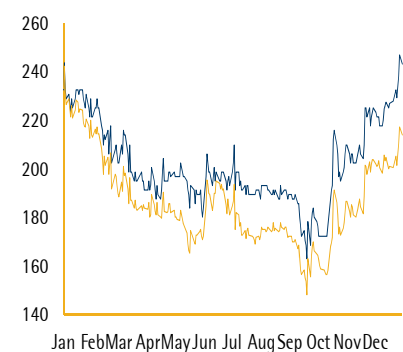
Adviser	Yes
Broker	Yes
NOMAD	Yes

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Share price performance (1 year)



Source: Thomson Datastream

Key financial data

Year to June	2012A	2013A	2014E	2015E	2016E
Production (boe/d)	250	261	1,935	2,699	6,430
Production growth yoy	n.a.	4%	641%	39%	138%
Oil production / total production	0%	0%	89%	89%	82%
Revenue (£m)	2.9	4.1	36.7	51.6	134.6
EBITDA (£m)	-5.5	-5.6	14.6	26.7	88.5
Operating cash flow (£m)	-1.0	-1.4	13.8	25.9	81.9
Brent oil price (\$US/bbl)	112.41	108.67	100.75	102.76	104.82
UK natural gas price (\$US/mcf)	9.23	10.40	10.83	11.16	11.49

Athena Field

- **Production:** The field is currently producing circa 7,500 bbls/d gross following some operational issues with electrical submersible pumps ("ESPs"). There is a work programme planned for 2014 to increase production materially. Based on our discussions with management we expect that it will cost \$27.2mn to install a new dual ESP to replace the failed ESPs in the A2z horizontal well. In our target price, we assume the well starts production from a new ESP at the beginning of calendar 2H 2014 and that the well will produce at a rate of 1,800 bbls/d. Production could be lower, but we believe that the balance of uncertainty favours upside. In particular, we believe outlier uncertainty favours production that would materially exceed our estimate. For perspective, the vertical A4 well has produced at stable rates exceeding 5,000 bbls/d. The A2z well was producing at circa 1,800 bbls/d when its second ESP failed; however, in the months prior to the ESP's failure, production declined rapidly while reservoir pressure approached virgin levels, suggesting that the 1,800 bbls/d rate may have been reduced by pump inefficiency. Allowing for production declines, we have assumed that the field will produce 8,400 bbls/d (gross) in calendar 2H 2014.
- **Increased recovery?:** We are now assuming that the Athena field produces 14% of the oil originally in place, which equates to a total gross recovery of 12.0 mn bbls. In comparison, Sproule International Limited, a specialist reservoir evaluator, estimates that the field's recovery rate should be 30%, provided that the reservoir is produced optimally without any operational issues. The key point is that due to operational challenges our estimates assume a considerable amount of oil is left unproduced in the reservoir. In the fullness of time, if the recovery rate for Athena can be increased to normal levels, the timing of Parkmead's acquisitions will probably coincide with the turning point for this field.
- **Risks:** Since first oil, production from the Athena field has been lower than originally anticipated. The A5, A3 and A2z wells have encountered operational hindrances, although the A4 well is producing in line with expectations. ESP pump failures, which are a standard/common operational occurrence, can be remediated by replacing the pumps. To date, intensive remedial work on the field has been limited. For this reason we have assumed that the field is shut-in at the end of 1H 2016 (leaving considerable amounts of oil unproduced). Our estimated shut-in timing is based on a study by Texas A&M University (*Electrical Submersible Pump Survival Analysis. Michelle Pflueger et al, Texas A&M University, March 2011*), which found that the mean run life of an ESP is circa 2.9 years, with tail risk favouring significantly longer run lives. Based on its historical performance, there is a risk of premature operational failure at the Athena field. There is also material scope for operational performance to exceed our expectations. Operational challenges can be remedied by capital expenditures.
- **Increasingly in the driver's seat:** Ithaca, the operator of the Athena field and 22.5% holder, and Parkmead have a combined stake of 52.5% in the field, giving them majority control. We believe this favours active development and production management of the field.
- **5th Producing Well?:** The field is currently producing from four wells. We estimate that 89% of production is from two wells. We believe that investing in new ESPs favours the eventual drilling of a fifth well because new ESPs would extend the life of the field and cover fixed operating costs. We therefore believe that it is increasingly possible that the intent to drill a fifth well will be announced over the course of 2014. We have included no value in our target price for this

possibility. Based on the assumption that a fifth well would produce at an initial rate of 3,600 bbls/d, we estimate that it would add incremental value of 47.6 p/share. We estimate that the value per incremental barrel of oil produced from a fifth well (and from extending the life of existing wells) would amount to \$17.68.

- **Key terms of acquisition:** Total consideration for the deal is \$11.2mn, which will be satisfied through \$8.0mn in cash and \$3.2mn in shares. The number of shares issued will depend on the share price at the time of completion. Completion is expected in February 2014. The effective economic date of the transaction is the beginning of November 2013. The actual consideration payable will be reduced by the field's significant cash flow from the time of the effective date. Given the current cash flow being generated by the field, the actual cash amount payable at completion could be less than \$2mn, with the share consideration being reduced pro-rata with the cash consideration.
- **Gross 100% value of the Athena field:** Stripping out the Gemini facility, we believe that on a tax-free basis, the Athena field has a total value of \$353mn. On an after-tax basis, the value will depend on the exact amount of tax-loss carry forwards and undeducted expenditures for tax purposes that each participant has to reduce the effect of the 62% marginal tax rate. All participants in the field benefit pro-rata from the £75mn (gross) small field allowance applicable for this field. Our valuation assumes that the field is shut-in at the end of calendar 1H 2016 after producing 12.0 mn barrels of oil. We are currently using a price deck of \$100/bbl for Brent crude oil, which we escalate at 2.0% p.a.

Asset, Valuation and Target Price Summary

Oil & Gas Assets	Type	Working Interest	Total Value Net to Company (NPV10)			Risky Value				Contribution to Target Price		Valuation Estimates	
			Total		Per	Geological Chance of Success	Commercial Chance of Success	Market Valuation Factor	Combined Valuation Factor	Total	per Share	Value \$/boe	Total Future Production (mnboe; net)
			USD (\$mn)	GBP (£mn)	Share (p/share)	(%)	(%)	(%)	(%)	(\$mn)	(p/share)	(\$/boe)	
UK Oil & Gas Assets													
Athena	Oil	30.0%	85.5	53.4	75.9	100%	100%	100%	100%	85.5	75.9	39.90	2.1
Perth Core	Oil	52.0%	156.4	97.8	138.8	100%	80%	100%	80%	125.1	111.0	7.27	21.5
Perth NW Terrace	Oil	52.0%	98.7	61.7	87.6	66%	80%	100%	53%	52.1	46.2	12.19	8.1
Perth NE Terrace	Oil	52.0%	84.7	52.9	75.2	50%	80%	100%	40%	33.9	30.1	12.28	6.9
Platypus	Gas	15.0%	16.6	10.4	14.7	100%	80%	100%	80%	13.3	11.8	6.43	2.6
Pharos	Gas	20.0%	40.2	25.1	35.7	66%	80%	100%	53%	21.2	18.8	6.93	5.8
Total UK Oil & Gas Assets			482.1	301.3	427.8					331.1	293.8	85.0	47.0
Netherlands Oil & Gas Assets													
Onshore Gas	Gas	15.0%	4.9	3.0	4.3	100%	100%	100%	100%	4.9	4.3	12.82	0.4
Geesbrug (2 wells)	Gas	15.0%	1.9	1.2	1.7	100%	50%	100%	50%	1.0	0.8	3.35	0.6
Ottoland	Oil & Gas	15.0%	0.6	0.4	0.6	100%	50%	100%	50%	0.3	0.3	2.32	0.3
Papekop	Oil & Gas	15.0%	11.0	6.9	9.8	100%	50%	100%	50%	5.5	4.9	15.11	0.7
Total Netherlands Oil & Gas Assets			18.5	11.5	16.4					11.7	10.3	9.42	2.0
Total Oil & Gas Assets			500.6	312.9	444.1	n.a.	n.a.	n.a.	n.a.	342.8	304.1	10.22	49.0
Balance Sheet and Other Adjustments													
Investment in Faroe Petroleum			7.8	4.9	6.9					7.8	6.9		
Aupec consulting business			30.0	12.5	17.7					30.0	17.7		
General & Admin Costs (PV10, four years, £3mn)			(13.7)	(8.6)	(12.2)					(13.7)	(12.2)		
Cash (30 June 2013)			19.7	12.3	17.5					19.7	17.5		
Cash paid to EWE for 20% of Athena			(8.0)	(5.0)	(7.1)					(8.0)	(7.1)		
Cash assumed from option exercise			2.2	1.4	2.0					2.2	2.0		
Loans (30/6/2013)			(3.2)	(2.0)	(2.8)					(3.2)	(2.8)		
Share appreciation rights			(13.8)	(8.6)	(12.2)					(13.8)	(12.2)		
Total			21.0	6.8	9.7					21.0	9.7		
Core NAV			521.6	319.7	453.8					363.8	313.8		
Lower Visibility Oil & Gas Assets													
UK Oil & Gas Assets													
Possum	Gas	0.2	14.1	8.8	12.5	50%	80%	100%	40%	5.6	5.0	13.43	1.1
Skerryvore	Oil	0.3	196.3	122.7	174.2	38%	80%	100%	30%	58.9	52.2	10.82	18.1
Athena 5th Well	Oil	0.1	53.7	33.6	47.6	100%	50%	0%	0%	-	-	17.68	3.0
Blackadder	Gas	0.2	38.8	24.3	34.4	10%	80%	100%	8%	3.1	2.8	6.58	5.9
Total UK Oil & Gas Assets			302.9	189.3	268.7					67.6	60.0	10.77	28.1
Netherlands Oil & Gas Assets													
Diever West	Gas	0.1	1.6	1.0	1.4	51%	50%	100%	26%	0.4	0.4	7.27	0.2
Total Netherlands Oil & Gas Assets			1.6	1.0	1.4					0.4	0.4	7.3	0.2
Total of Lower Visibility Assets			304.5	190.3	270.2	n.a.	n.a.	n.a.	n.a.	68.0	60.3	18.0	28.3
Net Asset Value and Target Price										431.8	374.2		

Financials

Balance sheet (£m)

Year to June	2011A	2012A	2013A	2014E	2015E	2016E
Cash and equivalents	1.3	7.7	13.3	24.7	39.0	21.7
Trade receivables	1.7	3.3	4.0	5.0	6.0	7.0
Inventories	-	-	-	1.2	1.2	1.2
Other current assets	-	-	-	-	-	-
Investments	7.1	6.5	4.4	-	-	-
Long-term assets	2.3	5.5	31.7	74.4	143.7	244.7
Total assets	12.3	22.9	53.4	105.3	189.8	274.5
Trade payables	0.8	4.1	8.7	7.5	7.5	12.0
Other current liabilities	0.3	0.1	0.4	0.4	0.4	0.4
Debt	-	3.0	2.0	8.0	53.0	53.0
Long-term deferred taxes	0.0	0.0	1.6	1.6	1.6	1.6
Other long-term liabilities	2.2	3.5	3.3	4.9	4.9	4.9
Total liabilities	3.3	10.7	16.0	22.4	67.5	71.9
Equity	9.0	12.3	37.3	82.9	122.3	202.6
Liabilities and equity	12.3	22.9	53.4	105.3	189.8	274.5

Company and Charles Stanley Securities

Income statement (£m)

Revenue	3.7	2.9	4.1	36.7	51.6	134.6
Cash opex	(2.0)	(1.4)	(2.1)	(15.0)	(18.6)	(39.6)
G&A costs	(5.3)	(5.5)	(7.7)	(7.1)	(6.3)	(6.5)
EBITDA	(3.6)	(4.0)	(5.6)	14.6	26.7	88.5
Depreciation	-	(0.7)	(0.7)	(7.3)	(6.4)	(21.6)
Operating profit	(3.6)	(4.7)	(6.3)	7.4	20.3	66.9
Other	1.7	-	1.2	-	-	-
Financial expenses	0.0	(0.2)	(0.1)	(0.2)	(0.3)	(4.3)
Profit (loss) on investments	0.1	-	(0.0)	-	-	-
Income tax	(0.1)	0.0	(0.3)	(0.7)	(0.6)	(2.4)
Earnings	(1.9)	(4.9)	(5.6)	6.5	19.5	60.3
Minority interests	-	-	-	-	-	-
Earnings for shareholders	(1.9)	(4.9)	(5.6)	6.5	19.5	60.3

Company and Charles Stanley Securities

Cash flow statement (£m)

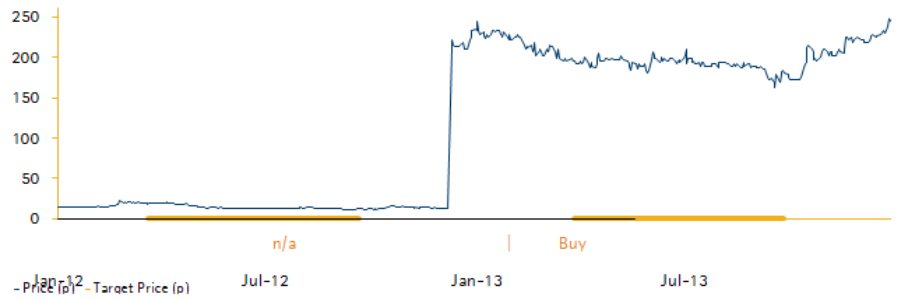
Earnings	(1.9)	(4.9)	(5.6)	6.5	19.5	60.3
Depreciation	0.1	0.1	0.4	7.3	6.4	21.6
Other	0.4	3.9	3.5	-	-	-
Deferred tax	0.0	0.0	0.3	-	-	-
Cash flow from operations	(1.3)	(1.0)	(1.4)	13.8	25.9	81.9
Changes in working capital	0.1	(1.5)	(3.4)	(3.4)	(1.0)	3.4
Cash from operations	(1.2)	(2.5)	(4.8)	10.4	24.9	85.3
Disposals	2.1	0.0	0.7	4.4	-	-
Investments	(0.1)	(2.9)	(8.4)	(37.4)	(75.7)	(122.6)
Cash from investments	1.9	(2.9)	(7.6)	(33.0)	(75.7)	(122.6)
Cash from equity raised	0.3	8.8	15.6	20.0	20.0	20.0
Net cash from debt capital	(0.0)	3.0	2.5	6.0	45.0	-
Cash from financing	0.3	11.8	18.1	26.0	65.0	20.0
Net change in cash	1.0	6.4	5.6	3.4	14.3	(17.3)

Company and Charles Stanley Securities

Important Disclosures

Recommendation and target price history

Share price performance



Charles Stanley Securities rating distribution

Total Coverage	Number	Percent	Banking Relationships	Number	Percent
Buy	69	67.65	Buy	26	78.79
Add	8	7.84	Add	1	3.03
Hold	21	20.59	Hold	6	18.18
Reduce	2	1.96	Reduce	0	0.00
Sell	2	1.96	Sell	0	0.00

Charles Stanley Securities rating definitions – 12 month time scale

Buy	+20% < expected absolute
Add	+10% < expected absolute < +20%
Hold	-10% < expected absolute < +10%
Reduce	-20% < expected absolute < -10%
Sell	expected absolute < -20%

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