

8 May 2014

Oil & Gas
FTSE AIM All Share

Parkmead Group

Buying Opportunity

We believe that Parkmead is easily the premium junior oil & gas company in Europe, based on the quality of the company's assets and the successful track record of its management team. The company is positioned to grow shareholder value, which we believe will translate into systematic increases in our valuation and target price. The current share price provides investors with the opportunity to acquire stock at an unwarranted 43% discount to our 380 p/share target price. We believe the current situation represents an excellent opportunity to acquire Parkmead shares and we reiterate our buy recommendation.

Price	217p
Price target	380p
12m high/low	294.5p / 163.1p
Market cap.	£190m
Net cash	£50m
Enterprise value	£140m
Free float	63%
Avg. daily volume	233k
Shares in issue	87.7m
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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- **2014 recap:** Since the beginning of the year, the company raised \$66 million (£40 million), reported a maiden half-year profit and closed the acquisition of 20% of the Athena field from EWE. The company's cash reserves (c. £51 million) are being strengthened by the daily oil & gas production from its assets. Behind the scenes, the company has been focusing its attention on assessing and applying for opportunities in the UK 28th Licensing Round.
- **Closing the EWE deal:** We feel that the market does not fully appreciate the extent of the value created by Parkmead's acquisition of 20% of the Athena field from EWE or the capital efficiency with which Parkmead completed this deal. Due to opportunistic timing, efficient tax structuring and the exclusive nature of the sales process Parkmead was able to acquire producing assets worth \$42.6 million at the time of closing (10 April 2014) for \$2.7 million in cash and 0.3 million Parkmead shares. We believe that the consideration paid to EWE by PMG was close to the balance of receivables and unsold inventory in respect of the acquired assets at the time of closing. We thought the equity market might have been worried about the deal being too good to be true and potentially at risk of being scuppered by a rival bid. However, it is worth pointing out that Tom Cross has never failed to complete an oil and gas deal in his 20-year history of running publicly-listed oil and gas companies. When the deal was announced on 30 December 2013, Parkmead shares were re-rated upwards to almost 300p, which we felt was a suitable adjustment. However, we are at a loss to explain the recent share price dynamics based on fundamentals. We estimate that the value created by securing this transaction amounts to 27p /share. We calculate that the assets acquired through this transaction (20% of the Athena field) are currently generating operating cash flow of \$2.3 million per month.

Share price performance (1 year)



Source: Thomson Datastream

Key financial data

Year to June	2012A	2013A	2014E	2015E	2016E
Production (boe/d)	250	261	1,132	2,384	6,283
Oil production / total production	0%	0%	82%	88%	81%
Revenue (£m)	2.9	4.1	24.3	46.2	127.0
EBITDA (£m)	-5.5	-5.6	9.4	24.2	84.0
Operating cash flow (£m)	-1.0	-1.4	6.5	22.1	75.2
Earnings (£m)	-4.9	-5.6	1.9	6.0	31.7
Brent oil price (\$/bbl)	112.41	108.67	105.88	101.25	103.27
UK natural gas price (\$/mcf)	9.23	10.40	11.21	11.24	11.46

Buying Opportunity

- **2014, what next?:** Catalysts for the remainder of the year include i) the workover of the P4 well at Athena, ii) the possibility of a decision later in the year to drill an additional (fifth) production well at Athena, iii) securing a rig to drill the Skerryvore prospect, iv) price upside from Parkmead's un-hedged oil and gas production, v) the announcement of a commercial agreement to develop the Parkmead-operated Perth field jointly with the nearby Lowlander and Dolphin oil fields, vi) an update on the resource assessment of the Dana-operated Pharos field (discovered in November 2013), vii) the potential award of licences through the 28th Licencing Round, viii) possible corporate and/or asset acquisitions and, ix) the advancement of projects within the company's prospect inventory to a drill-ready status.
- **Price impact of catalysts:** The catalysts noted above would be material to our target price in different ways. In our target price, we have assumed that repairing the P4 well will increase production by 1,800 bbls/d; however, we believe the balance of risk favours a higher rate of production, which would result in a positive uplift to our target price. We have included no value at all for the potential of a fifth production well at Athena, because no firm decision has been made to drill a well. In a success case, we estimate that a fifth well could add circa 35p/share. Securing a semi-submersible rig to drill Skerryvore would not change our valuation of the prospect, unless the timing of the well was brought forward from 2H 2015, which is likely according to Parkmead. Nonetheless, when an E&P company announces that it has secured a rig to drill an exploration prospect, the equity market focuses its attention on the prospect which often has a positive price impact. We have assumed that the Perth field is developed independently in our valuation. By sharing costs with the Lowlander and Dolphin fields, a joint development should add shareholder value and the exact amount of the benefit will depend on the commercial arrangement and development plan. We also believe an update on Pharos will increase the chance of success for the nearby Blackadder prospect (currently 33% in our target price) and result in an upward revision to our valuation of the area. New oil & gas projects acquired through the award of new licenses and the progression of projects within the company's current opportunity set need to be matured before we include them in our target price and we expect the company to progress one or two such projects every year. We believe that the EWE transaction serves as a very clear indicator of how efficiently Parkmead can create value through acquisitions.
- **Perspective on market valuation:** We find it remarkable that a company executing transactions such as the EWE deal described herein is trading below its core NAV of 286.9 p/share, which reflects only the value of discovered assets. In our opinion, Parkmead is a premium company trading at a steep discount, which we believe is illogical. We would expect investors to benefit from a near-term gain as the unwarranted discount to the company's fundamental value is corrected. Our 380 p/share target price also includes modest (risked) valuations for the assets in the company's exploration portfolio, which offer material success case upside. For example we have included 39.0 and 43.9 p/share of value for Skerryvore and Davaar respectively in our target price, whereas we estimate their full success case values are 130.1 and 351.3 p/share respectively.

We have provided an updated valuation table on page 3 and updated financial projections on page 4. These estimates reflect the closing of the EWE deal on 10 April 2014.

Asset, Valuation and Target Price Summary

	Type	Working Interest	Total Value Net to Company (NPV10)			Risky Value					Valuation Estimates		
			Total		Per Share	Geological Chance of Success	Commercial Chance of Success	Market Valuation Factor	Combined Valuation Factor	Contribution to Target Price		Value \$/boe	Total Future Production
			USD (\$mn)	GBP (£mn)	(p/share)	(%)	(%)	(%)	(%)	Total (\$mn)	per Share (p/share)	(\$/boe)	(mnboe; net)
Oil & Gas Assets													
UK Oil & Gas Assets													
Athena	Oil	30.0%	62.2	37.6	40.3	100%	100%	100%	100%	62.2	40.3	34.53	1.8
Perth Core	Oil	52.0%	169.2	102.2	109.8	100%	80%	100%	80%	135.4	87.8	7.87	21.5
Perth NW Terrace	Oil	52.0%	101.9	61.6	66.1	66%	80%	100%	53%	53.8	34.9	12.58	8.1
Perth NE Terrace	Oil	52.0%	87.6	52.9	56.8	50%	80%	100%	40%	35.0	22.7	12.70	6.9
Platypus	Gas	15.0%	21.0	12.7	13.6	100%	80%	100%	80%	16.8	10.9	8.50	2.5
Pharos	Gas	20.0%	40.1	24.2	26.0	66%	80%	100%	53%	21.2	13.7	6.74	6.0
Total UK Oil & Gas Assets			482.0	291.2	312.7					324.3	210.4	82.9	46.7
Netherlands Oil & Gas Assets													
Onshore Gas	Gas	15.0%	4.4	2.7	2.9	100%	100%	100%	100%	4.4	2.9	13.03	0.3
Geesbrug (2 wells)	Gas	15.0%	2.0	1.2	1.3	100%	50%	100%	50%	1.0	0.6	3.45	0.6
Ottoland	Oil & Gas	15.0%	0.7	0.4	0.4	100%	50%	100%	50%	0.3	0.2	2.44	0.3
Papekop	Oil & Gas	15.0%	11.5	6.9	7.4	100%	50%	100%	50%	5.7	3.7	15.70	0.7
Total Netherlands Oil & Gas Assets			18.6	11.2	12.0					11.5	7.5	9.66	1.9
Total Oil & Gas Assets			500.5	302.4	324.7	n.a.	n.a.	n.a.	n.a.	335.8	217.9	10.29	48.6
Balance Sheet and Other Adjustments													
Investment in Faroe Petroleum			9.0	5.5	5.9					9.0	5.9		
Aupec consulting business			20.7	12.5	13.4					20.7	13.4		
General & Admin Costs (PV10, four years, £3mn)			(15.7)	(9.5)	(10.2)					(15.7)	(10.2)		
Cash (31 December 2013)			21.0	12.7	13.6					21.0	13.6		
Cash paid to EWE for 20% of Athena			(2.7)	(1.6)	(1.7)					(2.7)	(1.7)		
Cash assumed from option exercise			13.1	7.9	8.5					13.1	8.5		
Loans excluding Gemini facility (31/12/2013)			(3.3)	(2.0)	(2.1)					(3.3)	(2.1)		
Cash from January 2014 fundraise			64.2	38.8	41.7					64.2	41.7		
Total			106.3	64.3	69.0					106.3	69.0		
Core NAV			606.8	366.7	393.7					442.2	286.9		
Lower Visibility Oil & Gas Assets													
UK Oil & Gas Assets													
Possum	Gas	15.0%	12.0	7.3	7.8	50%	80%	100%	40%	4.8	3.1	11.88	1.0
Skerryvore	Oil	30.5%	200.6	121.2	130.1	38%	80%	100%	30%	60.2	39.0	11.06	18.1
Davaar	Oil	30.0%	541.4	327.1	351.3	25%	50%	100%	12.5%	67.7	43.9	9.75	55.5
Athena 5th Well	Oil	30.0%	54.0	32.6	35.0	100%	50%	0%	0%	-	-	18.60	2.9
Blackadder	Gas	20.0%	40.7	24.6	26.4	33%	80%	100%	27%	10.8	7.0	6.90	5.9
Total UK Oil & Gas Assets			848.6	512.8	550.6					143.5	93.1	10.16	83.5
Netherlands Oil & Gas Assets													
Diever West	Gas	0.1	1.7	1.0	1.1	51%	50%	100%	26%	0.4	0.3	7.64	0.2
Total Netherlands Oil & Gas Assets			1.7	1.0	1.1					0.4	0.3	7.6	0.2
Total of Lower Visibility Assets			850.3	513.8	551.7	n.a.	n.a.	n.a.	n.a.	143.9	93.3	17.8	83.7
Net Asset Value and Target Price			1,457.1	880.4	945.4					586.1	380.2		

Charles Stanley Securities

Key assumptions:

Brent price of \$100/bbl escalated at 2% p.a.; UK gas price of 68p/therm (\$10.71/mcf) escalated by 2% p.a.; Exchange rate of \$1.65 = £1.00
Asset values are based on after-tax discounted cash flow models for each asset using a 10% discount rate (a standard NPV10 approach to oil & gas assets)

Financials

It is known that commodity prices, acquisitions, dispositions, farm-outs, successful discoveries and unforeseen growth opportunities will evolve in ways that are not possible to predict in advance. Investors should consider that our financial estimates are for indicative purposes only.

Our financial statement projections reflect the assumption that the Perth field will be developed as a stand-alone asset. In reality, we expect that the Perth field will be developed jointly with the Lowlander and Dolphin fields, which would i) defer the capital expenditure requirements for Perth ii) lower the company's share of the capital expenditure requirements in respect of Perth and iii) increase the value of Perth to the company.

Balance sheet (£m)						
Year to June	2011A	2012A	2013A	2014E	2015E	2016E
Cash and equivalents	1.3	7.7	13.3	43.9	69.8	13.0
Trade receivables	1.7	3.3	4.0	8.6	9.6	10.6
Inventories	-	-	-	0.1	0.1	0.1
Other current assets	-	-	-	-	-	-
Investments	7.1	6.5	4.4	4.6	4.6	4.6
Long-term assets	2.3	5.5	31.7	63.7	86.9	221.6
Total assets	12.3	22.9	53.4	120.9	171.0	249.9
Trade payables	0.8	4.1	8.7	10.6	10.6	10.6
Other current liabilities	0.3	0.1	0.4	0.5	0.5	0.5
Debt	-	3.0	2.0	7.9	52.0	99.1
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	5.4	5.4	5.4
Total liabilities	3.3	10.7	16.0	25.9	70.0	117.1
Equity	9.0	12.3	37.3	95.0	101.0	132.8
Liabilities and equity	12.3	22.9	53.4	120.9	171.0	249.9

Company and Charles Stanley Securities

Income statement (£m)						
	2011A	2012A	2013A	2014E	2015E	2016E
Revenue	3.7	2.9	4.1	24.3	46.2	127.0
Cash opex	(2.0)	(1.4)	(2.1)	(10.7)	(17.8)	(38.3)
G&A costs	(5.3)	(5.5)	(7.7)	(4.2)	(4.2)	(4.6)
EBITDA	(3.6)	(4.0)	(5.6)	9.4	24.2	84.0
Depreciation	-	(0.7)	(0.7)	(9.7)	(16.1)	(43.5)
Operating profit	(3.6)	(4.7)	(6.3)	(0.4)	8.1	40.6
Other	1.7	-	1.2	5.0	-	-
Financial expenses	0.0	(0.2)	(0.1)	(2.0)	(1.5)	(6.5)
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)	1.9	6.0	31.7
Minority interests	-	-	-	-	-	-
Earnings for shareholders	(1.9)	(4.9)	(5.6)	1.9	6.0	31.7

Company and Charles Stanley Securities

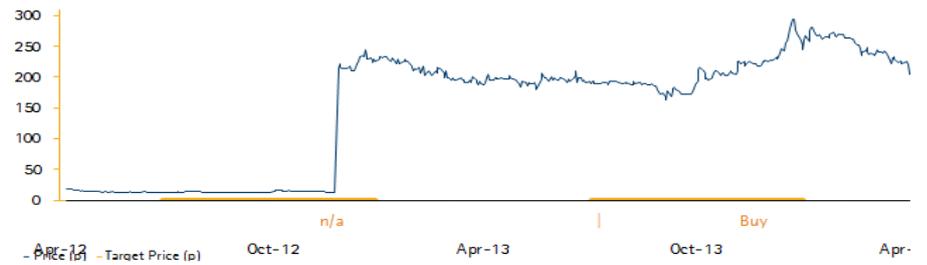
Cash flow statement (£m)						
	2011A	2012A	2013A	2014E	2015E	2016E
Earnings	(1.9)	(4.9)	(5.6)	1.9	6.0	31.7
Depreciation	0.1	0.1	0.4	9.7	16.1	43.5
Other	0.4	3.9	3.5	(5.3)	-	-
Deferred tax	0.0	0.0	0.3	0.1	-	-
Cash flow from operations	(1.3)	(1.0)	(1.4)	6.5	22.1	75.2
Changes in working capital	0.1	(1.5)	(3.4)	0.6	(1.0)	(1.0)
Cash from operations	(1.2)	(2.5)	(4.8)	7.0	21.1	74.2
Disposals	2.1	0.0	0.7	-	-	-
Investments	(0.1)	(2.9)	(8.4)	(14.6)	(39.3)	(178.1)
Cash from investments	1.9	(2.9)	(7.6)	(14.6)	(39.3)	(178.1)
Cash from equity raised	0.3	8.8	15.6	39.9	-	-
Net cash from debt capital	(0.0)	3.0	2.5	(1.7)	44.1	47.2
Cash from financing	0.3	11.8	18.1	38.2	44.1	47.2
Net change in cash	1.0	6.4	5.6	30.6	25.9	(56.8)

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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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