

3 April 2014

Support Services
FTSE AIM All-Share

Interim results

Buy (n/c)

Parkmead Group

Growth Plans Being Delivered

We believe Parkmead's interim results (announced 28 March 2014) reflect the steady growth of the company. The results provide comfort that the growth trajectory of the company is being translated into financial results as anticipated. We reiterate our 380p/share target price and our Buy recommendation.

- **Skerryvore:** In terms of operational updates, the company stated that they are accelerating work on the high-impact Skerryvore oil prospect, which we value at 131.0p/share in a success case, but are including only 30% of that value in our target price, 39.3p/share, to reflect risk. We believe it is possible that the company, which operates the relevant licence area, could announce a rig has been secured to drill the well at any time. Typically, that type of announcement galvanises investor interest and serves as a catalyst. After reviewing this prospect in detail, we are bullish on Skerryvore and would be delighted if a well could be drilled prior to 2H 2015, which is currently factored into our financial outlook.
- **Gain from Lochard acquisition:** The £2.6 million profit reported by the company reflects, amongst other things, that a "gain on bargain purchase" of £5.0 million was reported in relation to the acquisition of Lochard. This clearly demonstrates the company's ability to secure attractive deals. In our experience, it is very unusual for a producing oil asset to be acquired for less than its accounting value, but nevertheless Parkmead has achieved this.
- **Free money:** Based on our analysis, the acquisition of 20% of the Athena field from EWE has already paid for itself. Effectively, we estimate that from the beginning of November 2013 (the economic date of the transaction) to present, the field has already generated more cash flow than the \$11.2 million notional consideration the company has agreed to pay for the asset upon completion.
- **Athena:** The Athena field is producing in line with our conservative expectations and we believe investors can feel comfortable with our valuation of this field. Our valuation assumes that only 13% of the field's original oil in place is produced, which is very conservative. We believe that drilling a fifth production well would increase the recovery rate to 24%, which would add 37.7 p/share to PMG's value. The partners in the field are discussing the location of a possible fifth well; however, in the absence of a firm commitment to drill the well we still believe it is premature to include any value for this potential in our target price.

Price	243p
Price target	380p
12m high/low	294.5p / 163.1p
Market cap.	£212m
Net cash	£50m
Enterprise value	£163m
Free float	63%
Avg. daily volume	143k
Shares in issue	87.4m
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)



	1m	3m	12m
— Price	-8.3	5.3	23.7
— Rel all share	-5.4	7.0	17.6

Source: Thomson Datastream

Key financial data (£m) - IFRS

Year to June	2012A	2013A	2014E	2015E	2016E
Production (boe/d)	250	261	1,188	2,384	6,283
Oil production / total production	0%	0%	82%	88%	81%
Revenue (£m)	2.9	4.1	25.6	46.2	127.0
EBITDA (£m)	-5.5	-5.6	10.4	24.2	84.0
Operating cash flow (£m)	-1.0	-1.4	7.5	22.1	75.2
Earnings (£m)	-4.9	-5.6	4.3	8.6	38.6
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

Growth Plans Being Delivered

- **Completion of the EWE deal imminent:** The EWE deal for 20% of the producing Athena oil field is progressing and completion is "expected to be announced shortly following the standard partner and government approvals process". The date of completion is irrelevant from an economic perspective because according to the terms of the acquisition PMG is entitled to the economic benefits of the relevant interest from 1 November 2013.
- **Athena:** We believe that the Athena field is producing at around 7,000 bbls/d (gross) which is a temporarily reduced rate that is consistent with the flow rate announced by Trap Oil on 22 January 2014 (7,000 bbls/d). We expect the company and the operator of the field, Ithaca Energy, to announce in the weeks/months ahead that a rig has been secured to fix a current operational problem (a failed electrical submersible pump package on the P4 well), which would increase production materially. This has been factored into our valuation. We believe that investors who have incorporated the above expectations into their valuations (as per our 380p/share target price) should be comfortable with the situation at Athena. We have been very conservative in our valuation of Athena by assuming it is shut-in for mechanical reasons (not reservoir performance) at the end of 1H 2016, even though we believe that mechanical problems are easily fixed. In the interim results, Parkmead stated that "locations are also being discussed for a potential new production well on the Athena oil field to extend the life of the field".
- **Athena, read across from Ithaca Energy:** Ithaca reported its annual results and held an analyst meeting on 31 March 2014. The company's reserve evaluator Sproule Associates reduced the amount of 2P reserves attributable to Athena by 6.6 million bbls (gross) to 12.9 million barrels. We are currently valuing Athena (conservatively) on the basis that it will produce 6.0 million bbls (gross). We believe that Sproule has taken the approach that the reservoir has the physical potential to produce 12.9 million barrels assuming the field has no mechanical challenges. Sproule's reserve write-down does not alter our forward-looking expectations. Ithaca confirmed that the partners of the Athena field are currently in discussions to secure a rig to replace the failed ESP pump package for the P4 well. However, we were somewhat disappointed to learn that despite being in active discussions about the optimal placement of a fifth well, our sense was that Ithaca would like more production history (particularly in relation to the water-cut) and reservoir analysis before committing capital to that project. Therefore we believe it is possible that the partners in the field might announce a decision to drill a fifth well in calendar 2014; however, we believe investors should have reasonable expectations relating to whether a well will be drilled in that year.
- **Perspective on Athena:** In our target price we have included 43.4 p/share of value for Athena (only 11% of our 380 p/share target price). A detailed valuation table is provided on page 3 of this note.
- **Accounting:** The company will accrue the economic benefits of the EWE deal starting in November 2013; however, we believe that revenue will only be reported on the income statement from the date of legal completion. Given that production from the Athena field is highly profitable, the longer it takes to complete, the lower the company's reported income will be. We have somewhat reluctantly changed all of our production and income statement estimates to reflect this approach. Therefore our estimate of earnings for 2014 (£4.3 million) understates substantially the economic profit we expect the company to generate in that period due to accounting convention

Our valuation is based entirely on our discounted cash flow model and not dependent on accounting conventions.

Asset, Valuation and Target Price Summary

			Total Value Net to Company (NPV10)			Geological		Commercial		Risked Value		Valuation Estimates	
			Total		Per	Chance of	Chance of	Market	Combined	Contribution to		Value	Total
			USD	GBP	Share	Success	Success	Valuation	Valuation	Total	per Share	\$/boe	Future
			(\$mn)	(£mn)	(p/share)	(%)	(%)	(%)	(%)	(\$mn)	(p/share)	(\$/boe)	Production
Oil & Gas Assets			Type	Working Interest									
UK Oil & Gas Assets													
Athena	Oil	30.0%	66.5	40.3	43.4	100%	100%	100%	100%	66.5	43.4	36.94	1.8
Perth Core	Oil	52.0%	169.2	102.5	110.5	100%	80%	100%	80%	135.4	88.4	7.87	21.5
Perth NW Terrace	Oil	52.0%	101.9	61.8	66.5	66%	80%	100%	53%	53.8	35.1	12.58	8.1
Perth NE Terrace	Oil	52.0%	87.6	53.1	57.2	50%	80%	100%	40%	35.0	22.9	12.70	6.9
Platypus	Gas	15.0%	21.0	12.7	13.7	100%	80%	100%	80%	16.8	11.0	8.50	2.5
Pharos	Gas	20.0%	40.1	24.3	26.2	66%	80%	100%	53%	21.2	13.8	6.74	6.0
Total UK Oil & Gas Assets			486.3	294.7	317.5					328.7	214.6	85.3	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	0.7	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	7.5	100%	50%	100%	50%	5.7	3.7	15.70	0.7
Total Netherlands Oil & Gas Assets			18.6	11.2	12.1					11.5	7.5	9.66	1.9
Total Oil & Gas Assets			504.9	306.0	329.7	n.a.	n.a.	n.a.	n.a.	340.2	222.1	10.38	48.6
Balance Sheet and Other Adjustments													
Investment in Faroe Petroleum			7.2	4.4	4.7					7.2	4.7		
Aupec consulting business			30.0	12.5	13.4					30.0	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	13.7					21.0	13.7		
Cash assumed to be payable to EWE for 20% of Athena (notional)			(8.0)	(4.8)	(5.2)					(8.0)	(5.2)		
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)	(2.2)					(3.3)	(2.2)		
Cash from January 2014 fundraise			64.0	38.8	41.8					64.0	41.8		
Total			108.2	59.9	64.5					108.2	64.5		
Core NAV			613.1	365.8	394.2					448.4	286.6		
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	121.6	131.0	38%	80%	100%	30%	60.2	39.3	11.06	18.1
Davaar	Oil	30.0%	541.4	328.1	353.5	25%	50%	100%	12.5%	67.7	44.2	9.75	55.5
Athena 5th Well	Oil	10.0%	57.8	35.0	37.7	100%	50%	0%	0%	-	-	19.93	2.9
Blackadder	Gas	20.0%	40.7	24.7	26.6	33%	80%	100%	27%	10.8	7.1	6.90	5.9
Total UK Oil & Gas Assets			852.5	516.6	556.6					143.5	93.7	10.21	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			854.2	517.7	557.7	n.a.	n.a.	n.a.	n.a.	143.9	93.9	17.8	83.7
Net Asset Value and Target Price			1,467.2	883.5	951.9					592.3	380.6		

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

Balance sheet (£m)

Year to June	2011A	2012A	2013A	2014E	2015E	2016E
Cash and equivalents	1.3	7.7	13.3	50.2	76.1	19.3
Trade receivables	1.7	3.3	4.0	6.0	7.0	8.0
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	61.3	87.0	228.6
Total assets	12.3	22.9	53.4	122.2	174.8	260.6
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	96.3	104.9	143.5
Liabilities and equity	12.3	22.9	53.4	122.2	174.8	260.6

Company and Charles Stanley Securities

Income statement (£m)

	2011A	2012A	2013A	2014E	2015E	2016E
Revenue	3.7	2.9	4.1	25.6	46.2	127.0
Cash opex	(2.0)	(1.4)	(2.1)	(10.9)	(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)	10.4	24.2	84.0
Depreciation	-	(0.7)	(0.7)	(8.4)	(13.6)	(36.6)
Operating profit	(3.6)	(4.7)	(6.3)	2.0	10.6	47.4
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)	4.3	8.6	38.6
Minority interests	-	-	-	-	-	-
Earnings for shareholders	(1.9)	(4.9)	(5.6)	4.3	8.6	38.6

Company and Charles Stanley Securities

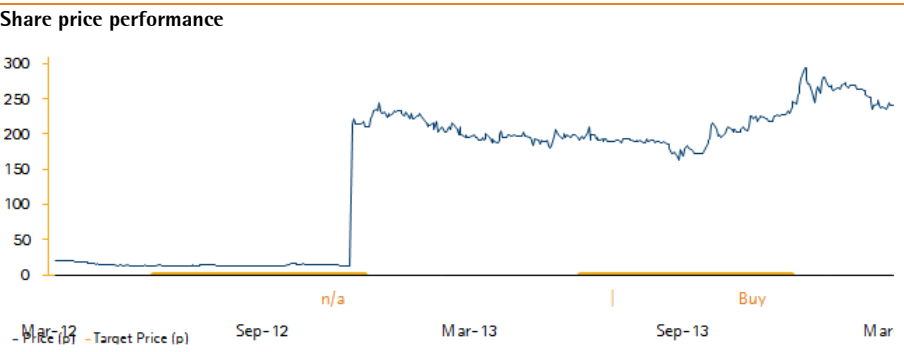
Cash flow statement (£m)

	2011A	2012A	2013A	2014E	2015E	2016E
Earnings	(1.9)	(4.9)	(5.6)	4.3	8.6	38.6
Depreciation	0.1	0.1	0.4	8.4	13.6	36.6
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)	7.5	22.1	75.2
Changes in working capital	0.1	(1.5)	(3.4)	3.2	(1.0)	(1.0)
Cash from operations	(1.2)	(2.5)	(4.8)	10.7	21.1	74.2
Disposals	2.1	0.0	0.7	-	-	-
Investments	(0.1)	(2.9)	(8.4)	(10.8)	(39.3)	(178.1)
Cash from investments	1.9	(2.9)	(7.6)	(10.8)	(39.3)	(178.1)
Cash from equity raised	0.3	8.8	15.6	38.8	-	-
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	37.1	44.1	47.2
Net change in cash	1.0	6.4	5.6	37.0	25.9	(56.8)

Company and Charles Stanley Securities

Important Disclosures

Recommendation and target price history



Charles Stanley Securities rating distribution					
Total Coverage	Number	Percent	Banking Relationships	Number	Percent
Buy	73	68.87	Buy	26	81.25
Add	10	9.43	Add	1	3.13
Hold	19	17.92	Hold	5	15.63
Reduce	2	1.89	Reduce	0	0.00
Sell	2	1.89	Sell	0	0.00

Charles Stanley Securities rating definitions – 12 month time scale			
Buy	+20%	< expected absolute change	
Add	+10%	< expected absolute change	< +20%
Hold	-10%	< expected absolute change	< +10%
Reduce	-20%	< expected absolute change	< -10%
Sell		expected absolute change	< -20%

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