PANMURE GORDON & CO

Founded 1876

Brendan Long, CFA

12 August 2015

Equity Research

BUY

Parkmead

Second tranche of the 28th licensing round builds on unrivalled licensing momentum

With Parkmead's 100% drilling success rate we are particularly excited to see DECC award Parkmead three new 28th Round blocks which have high-quality and high-impact exploration prospectivity. The purpose of this company update is to provide investors with a means of evaluating the quality and impact of the newly awarded blocks.

- **Potential value impact:** We estimate that the success case values of the Sanda North, Sanda South and Selene prospects, which are now part of Parkmead's exploration portfolio, amount to 203p per share, 153p per share and 136p per share respectively.
- **Bang for your Block:** The prospects awarded through the blocks are easily some of the best in the company's portfolio, in our opinion, and change our thinking about the impact exploration could have for Parkmead shareholders.
- **West of Shetland Area:** We believe Parkmead is now well positioned to dominate a strategic hub in the Shetland-Faroe Trough subject to exploration success. Parkmead's hub would compare to that of BP in the area, where £3 billion is currently being invested in a redevelopment project.
- **Selene:** Selene is now by far the most significant exploration asset in Parkmead's Southern North Sea portfolio, because of its material scale (P50 estimate of 253 bcf or 42 million boe) and because Parkmead holds a 50% interest in the prospect. We were optimistic about Pharos before it was successfully discovered by Parkmead in November 2013 and we believe Selene has a higher chance of success (38% – very bullish for a sell-side analyst) than Pharos (33% – our pre-drill estimate). We base this assessment on the robustness of the geology at Selene.
- **Conservative Target Price:** We will wait until Parkmead makes public its intention to drill a well at Selene before including it (risked) in our target price. Similarly, we will wait until Davaar is a proven discovery before including value for the Sanda North and Sanda South follow-on targets in our valuation. Our approach is to include only prospective value in our target price for exploration prospects where we are reasonably certain that a well will be drilled to test the target(s).
- **Perspective:** In addition to building on its exploration success, we believe acquisitions, appraisal drilling and project development will remain the core drivers of shareholder value creation in Parkmead.
- **Acquisitions Ahead:** Parkmead typically makes a corporate acquisition once every four months, it has circa £42 million of cash and it may use the recent downturn in commodity prices to secure an acquisition on attractive terms.

Target Price: 294p

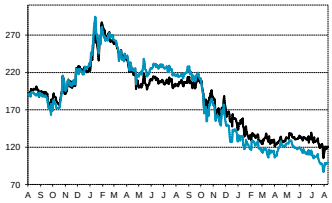
Share Price: 100p

Key Data

Market Cap	£98m
Sector	Oil & Gas Producers
Stock Codes	PMG.L / PMG LN

Last Published Research: 31 July 2015

Absolute & Relative Performance



— *Absolute*

— *Relative to DS Oil & Gas*

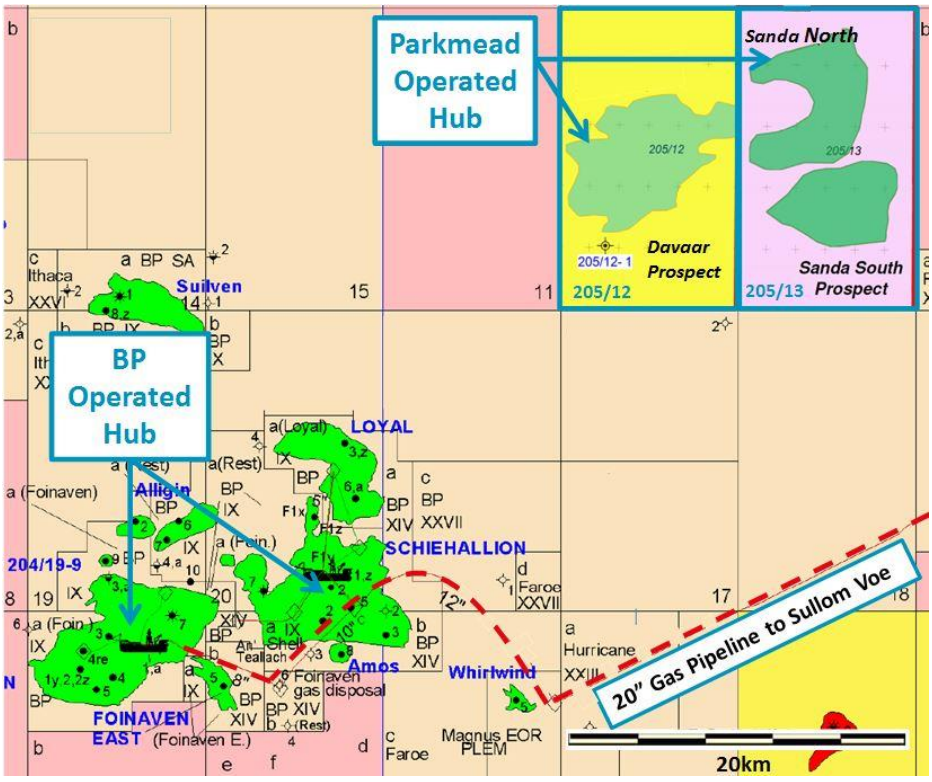
Source *Datastream*

For more research www.panmure.com

BLOCK 205/13 – PARKMEAD 56%, OPERATOR

We see the award of a high-working interest and operatorship in a block adjacent to the Davaar prospect (Block 205/12 – operated and 30% held by Parkmead) as something of a strategic asset build in Parkmead's exploration portfolio in the Faroe-Shetland Trough, where multiple world class oil fields have been discovered. With considerable geological and geophysical expertise being brought to bear, with only modest committed capital outlays, we believe the company has assembled exploration prospects that, if successful, would combine to create a "Strategic Hub" that would compare to BP's presence in the area.

Parkmead has established a strategic presence in the West of Shetland area



Source *Parkmead, Panmure Gordon*

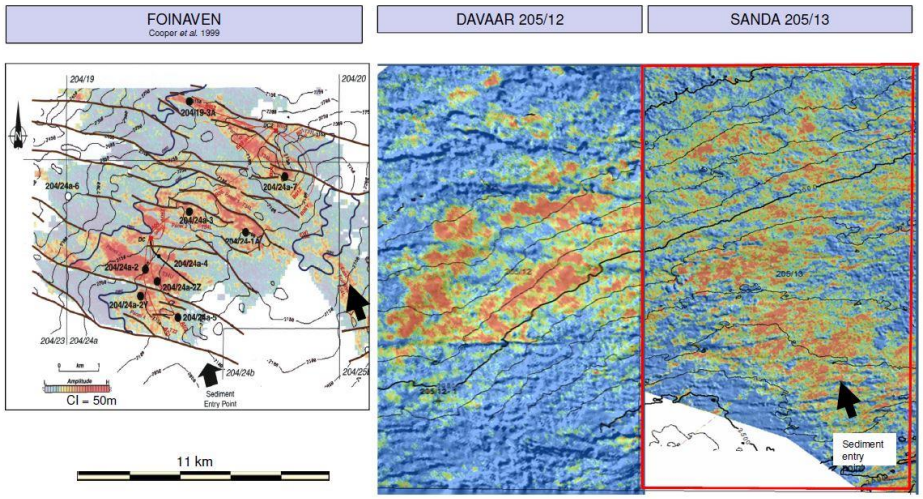
- **Prospects:** Parkmead has identified two large prospects within block 205/13, Sanda North and Sanda South for which the P50 (best) estimates of gross recoverable oil, in a success case, are 71 million barrels and 55 million barrels respectively. This compares to the 186 million barrel P50 gross recoverable oil estimate for Davaar. All three prospects are targeting a single turbidite system and they all share a specific seismic signature. Therefore, we believe that the award of Block 205/13 to Parkmead essentially increases the upside of Davaar, which is important because incremental oil accumulations increase the value per barrel of oil produced and a greater project scale attracts the interest and capital of major international oil companies. The combined gross P10 (high case) estimate of the recoverable oil from all the prospects, in a success case, is 517.9 million barrels of oil. Experience within the area suggests that, in a successful exploration scenario, the recoverable oil estimates tend to converge towards the upside case as greater knowledge of these stratigraphic fields is acquired through appraisal drilling and seismic analysis.
- **Hub Strategy:** Rather than collecting interests in disparate fields, Parkmead tends to focus on hub-based developments where it has the strategic dominance in terms of production facilities and geological expertise. This strategy also yields economic results. We expect Sanda North and Sanda South to have values of $9.42/barrel and $9.11/barrel, respectively, which is higher than the $7.01/barrel estimate we have for Davaar, because Davaar will carry most of the capital and operating cost burden for the hub.

- **Direct Hydrocarbon Indicators:** The Vaila sandstone reservoir structures in the area are largely stratigraphic and do not lend themselves to the use of conventional seismic imagery. Advanced quantitative techniques are therefore applied with a view to identifying hydrocarbons directly based on the fluid properties of hydrocarbons compared to the salt water brine that generally saturates porous rocks. The direct hydrocarbon indicator that supports the prospectivity of Davaar, Sanda North and Sanda South is a relative softening of the seismic amplitude signal in the area that is thought to be hydrocarbon bearing. Importantly, the Davaar anomaly (which is identical to the Sanda North and Sanda South anomalies) is present only on the downthrown side of a main bounding fault for the reservoir (as seen in the image below). If the anomaly was a lithological effect it would be expected to be present on both sides of the fault because the fault post-dates the deposition i.e. the same lithology (rocks) should be present on both sides of the fault. It is common for oil (and gas) fields to exist on one side of a fault with water on the other side. Importantly, Foinaven, which we have used as our reference field in the area, exhibits a very similar seismic character, with amplitude anomalies trending alongside faults (as seen in the image below). This is why, in our assessment, the identified prospects are extremely compelling and why success at Davaar would materially derisk Sanda North and Sanda South.

The structural maps to the right are scaled similarly. Davaar is massive in areal scale relative to Foinaven. We believe that if successful, the Davaar reservoir may be thicker than Foinaven assuming that the areal/height geometry is similar to that of Foinaven, which we believe would be the most logical assumption given that the sands are turbidite deposits. However, we believe that based on seismic interpretation, the assumed thickness of Davaar is only about one third of that of Foinaven. We believe that seismic (without well control) cannot accurately determine net pay for Davaar. Therefore we believe that material upside relative to the 166 million barrel estimate is much more likely than downside (assuming a high quality reservoir is encountered).

For a more comprehensive assessment of the regional petroleum system please refer to our note entitled: "Davaar: Out of the Deep" which was published on 19 February 2014.

Amplitude Anomalies Conform to Faults



Source *Parkmead*

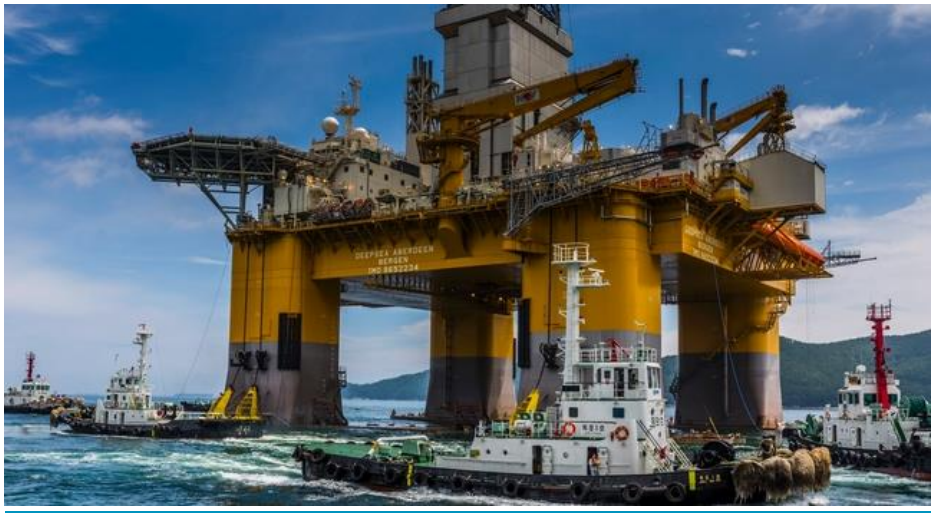
- **Proven Petroleum System:** The petroleum system for Blocks 205/12 and 205/13 is well understood and known to be effective. Oil is sourced from the Jurassic Kimmeridge Clay Formation. Migration is via faults and permeable rocks. The Vaila Formation is the reservoir target for the Davaar and Sanda prospects and is the reservoir for the nearby Foinaven and Schiehallion fields. The primary reservoir intervals are high density turbidite flows. Typical Vaila Formation reservoir porosities range from 9% to 31% with permeabilities of 10 to 7,000 mD, making them excellent reservoirs. The reservoir intervals in the area are sealed by mudstones that are also of the Vaila Formation. We are encouraged to see highly prospective and high-impact exploration in a petroleum basin where the petroleum system is well understood and proven to be effective.

Foinaven is now expected to produce 415 million barrels of oil, which is twice the original recoverable resource estimate. Schiehallion has produced 400 million barrels of oil and its redevelopment is projected to produce an additional 450 million barrels.

Foinaven was originally drilled in 1990, but the official discovery of the field occurred two years later when new seismic technology acquired by BP and Shell in the Gulf of Mexico was applied to realise the significance of the field.

- **BP and its co-venturers Shell and OMV are committed to the area:** In the context of lower oil prices on, 29 April 2015, BP announced it had commenced a seven year drilling campaign on the Loyal and Schiehallion fields with the newly built Deepsea Aberdeen rig. The rig is a purpose built sixth generation dual derrick rig owned by Odfjell Drilling. Trevor Garlick, Regional President for BP's North Sea business said: "The drilling campaign not only demonstrates our commitment to the region in what is a challenging time but will also help maximise production from Schiehallion and Loyal". BP and its co-venturers are also constructing a new FPSO in Korea, the Glen Lyon, to produce the Schiehallion and Loyal fields starting in 2016. In total, according to BP, the refurbishment of the Schiehallion and Loyal fields will require a capital investment of £3 billion.

Deepsea Aberdeen on its way to maiden drilling at Loyal / Schiehallion



Source *Odfjell Drilling*

- **Value:** We have built a sophisticated development model to value the potential of Parkmead's West of Shetland prospects. We estimate that, if successful, the net value to the company of Davaar, Sanda North and Sanda South would be $368 million (223.9 p/share), $334 million (203.4 p/share) and $251 million (152.9 p/share), respectively. At present, we have only included only 37.3 p/share of value in our target price to reflect 16.7% of the success case value of Davaar (reflecting a 25% chance of geological success and a 66.6% chance of commercial success). *We have assumed a $70/bbl long-term Brent oil price which we escalate at 2% p.a.*

- **Triggers to Unlock Value:** As plans to drill a well take shape, inclusive of completing further seismic analysis, the detailing of a drilling schedule and the contracting of a rig, we will gradually include more value for the company's West of Shetland assets in our target price. Ultimately, the drilling of a well has the most potential to unlock value by proving up the geological success of the prospect.

- **Licences/work programme**: The licences for Blocks 205/12 and 2015/13 are traditional four year exploration licences. The principal geological and geophysical work programme in respect of the licences consists of reprocessing seismic data to generate AVO/Inversion volumes. Parkmead has the option of relinquishing the licences or drilling a well prior to the end of the licence term, which will occur in October 2016 and August 2019, for blocks 205/12 and 205/13 respectively.

- **Partners:** Atlantic Petroleum (30%) and Dyas (14%) are Parkmead's partners in Block 205/13. Block 205/12 is held by Parkmead (30% operator), Atlantic Petroleum (30%), Dyas (14%) and Summit Petroleum (26%).

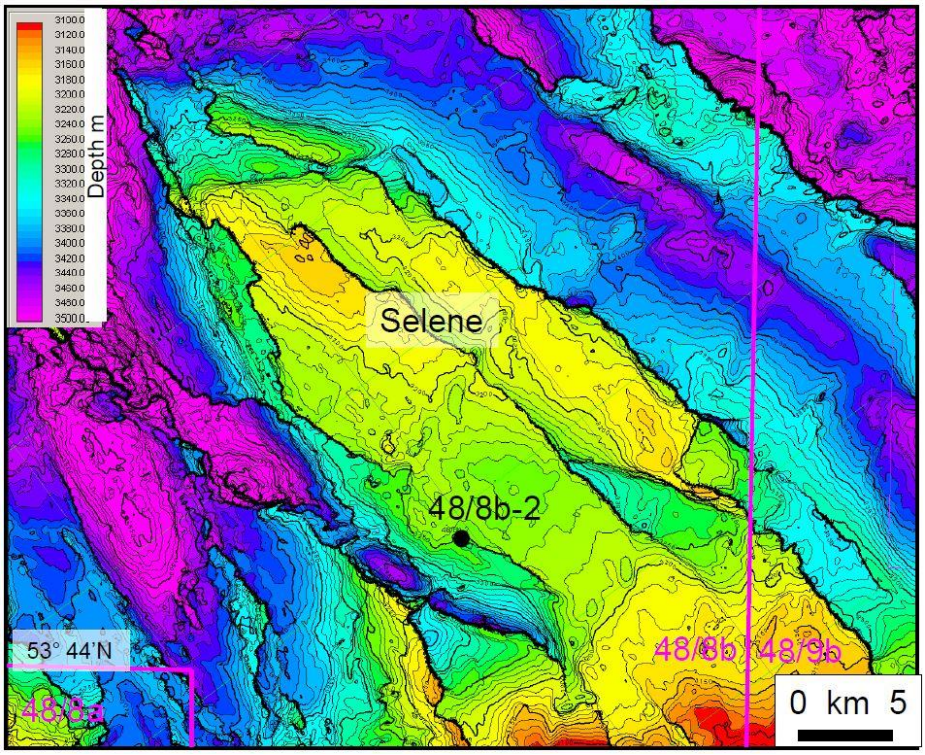
- **Geographic Location:** The prospects are located circa 100 km west of the Shetland Islands in water depths of circa 500m.

BLOCK 48/8B – PARKMEAD 50%

We believe that the Selene gas prospect in Block 48/8b in the Southern North Sea is an exceptionally high-quality exploration target in a well understood petroleum basin. The gross P50 (best) estimate of recoverable gas is 253 bcf (42 million boe). The prospect is located in an excellent exploration fairway where drilling efforts have resulted in many gas finds and few dry holes.

- **Selene:** The Selene prospect is a single massive uplifted and fault/dip bounded structure. We believe the structure is exceedingly robust with 140m of closure (from the crest of the structure to the spill point) with the geometry being defined principally by faults. The overburden complicates seismic mapping as does the possibility of inversion (the possibility of the rocks being buried deeper than they currently are which compresses the rock and changes its seismic velocity and generally introduces uncertainty into the seismic data). Parkmead's successfully discovered Pharos field had a similarly complex overburden and it was this dip closed structure which increased the reliance on seismic data to define it (the principal determinant of the geological chance of success for the prospect). Yet with 183m of estimated structural closure our pre-drill opinion was that Pharos was structurally robust. We have much more confidence in Selene's structural integrity because the seismically defined structure conforms to faults and there is local well control (48/8b-2 well).

Selene Structure Map (Depth at top of Rotliegend) and 48/8b-2 Well Location



Source *Parkmead*

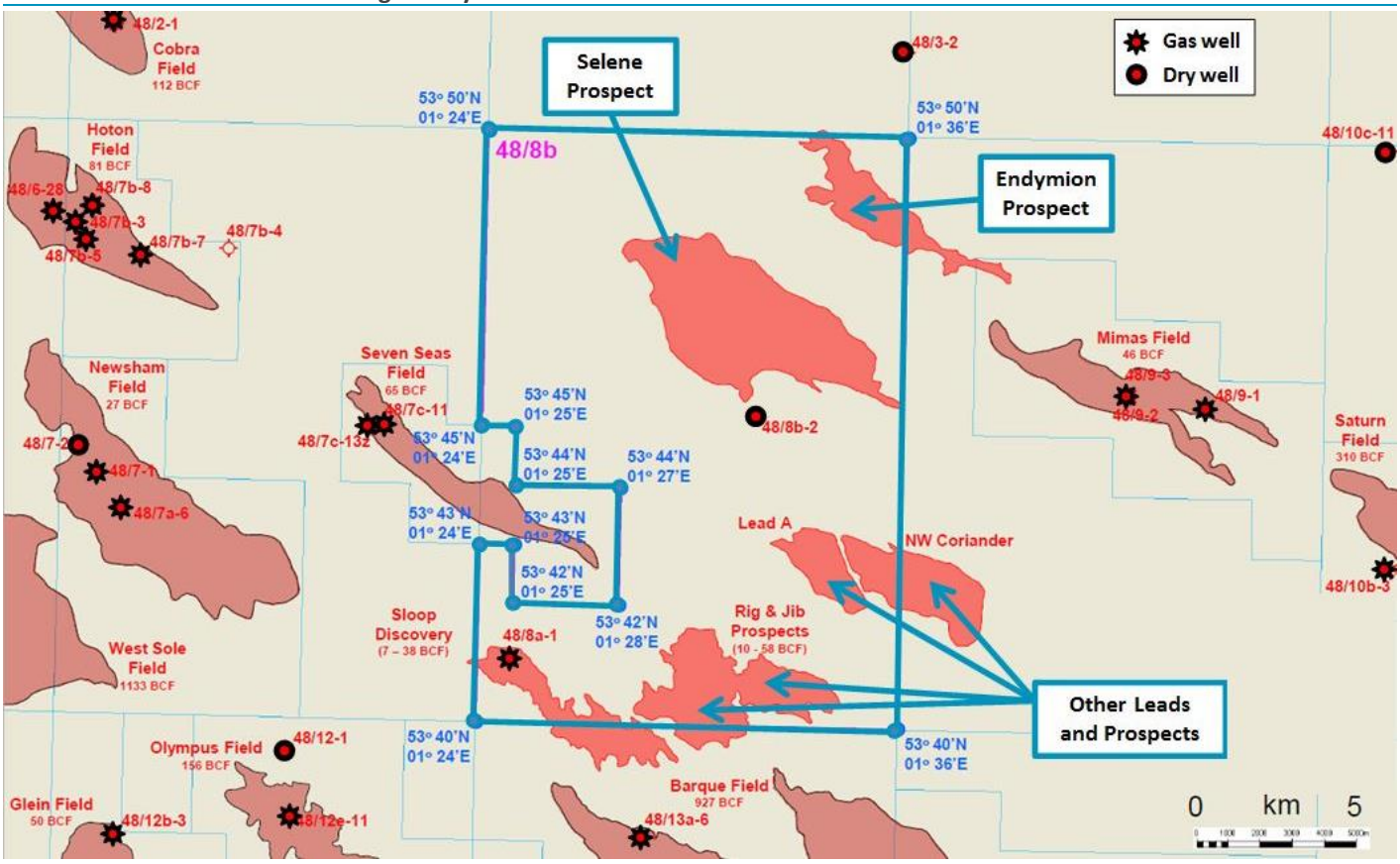
- **48/8b-2 Well:** It is believed that Amerada Hess's nearby 48/8b-2 well was unsuccessful because it was drilled on the outskirts of Selene and it is unclear whether the well, drilled in 1989, encountered gas or water in the targeted Lower Leman section. The quality of the Lower Leman Sandstones penetrated by 48/8b-2 was adversely affected by the proximity of a major fault, which tends to introduce mineralization or diagenesis. The 5.4% porosity of the Lower Leman Sandstone encountered by 48/8b-2 is therefore not representative of the quality of sands that can be expected within Selene itself. Sands in the area typically have porosities between 10% and 15%. The well did, however, penetrate 225m of Westphalian Coals ensuring the presence of a gas generative source

rock. Also the well recorded significant gas shows while tripping the drill string. The well essentially corroborates the view that for Selene the risking is essentially limited to reservoir composition. Much of the conclusive seismic reprocessing done over the block is proprietary and we do not believe that 48/8b-2 would have been drilled where it was if Amerada Hess had been in possession of Parkmead's knowledge of the structure.

- **Proven and Effective Petroleum System:** The block lies in the Rotliegend Lower Leman Sandstone fairway where the petroleum system has proven to be regional and effective. Gas in the region is sourced from Carboniferous Westphalian Coals and reservoirs are sealed by Rotliegend Silverpit shales and Zechstein evaporates (salts), both of which are ubiquitous and reliable in the area. The targeted reservoir sands, the Permian Lower Leman Sandstones, are also universally present in the region. The Lower Leman Sandstones consist of a number of variable facies including those from aeolian, dune and fluvial depositional environments and they also vary in quality due to the degree to which they have been inverted (they may have been buried deeper than their current depth before being inverted or uplifted into their current position). Diagenesis, or a change of reservoir quality due to mineral and chemicals passing through the reservoir can also cause variability in porosity and permeability. We believe that in the main the depositional environments relating to the area (deserts for example) are massive in scale and risks to reservoir quality, in our opinion, would require specific (and less likely) geological developments. On balance, the Southern North Sea is one of the most understood and encouraging environments globally for exploration.

- **Location, location, location:** The map below shows that the area around the Selene prospect has produced many successful discoveries with relatively few dry holes. We believe this is because the petroleum system is regionally robust and because the targeted reservoirs are structural traps.

Location of Selene and local drilling history



Source *Parkmead, Panmure Gordon*

- **Building on success in the Southern North Sea:** Since inception, Parkmead has only committed capital to successful wells. In our opinion, shareholders can expect the company to build on the success of the Pharos and Platypus discoveries in the Southern North Sea. The area is gas rich, it has extensive infrastructure and few companies in the area have as much in depth experience as Parkmead. We are comforted that Parkmead's management team, while at Dana Petroleum, brought the Babbage gas field (20km to the north west of Block 48/8b) onstream. We would like to see Parkmead drill aggressively in the area and are looking forward to newsflow relating to the drilling of Blackadder – an extension of Parkmead's successful Pharos discovery. We are also looking forward to the submission of a field development plan for the Platypus gas discovery which is expected before 2015 year-end.
- **Valuation:** In the case of exploration success, we estimate that Selene would have a value of $224 million net to Parkmead (136.3 p/share). This would amount to $11.37/boe or $1.89/mcf. Our valuation model for the field assumes that it would be produced with six horizontal wells. We assume that the gas would be produced to an unmanned platform before being piped to third party facilities (perhaps to the facilities at West Sole although there are other options).
- **Geological Chance of Success:** We have assumed that there is a circa 38% chance of geological success for Selene, which reflects a very conservative assumption relating to the possibility that lower quality reservoir is encountered (reflecting our assessment of the possibility of diagenesis or increased compression from inversion).

Selene's probability of geological success (%)

	Assumed probability	*Probability of success*
Probability of inversion	*100%*	*n.a.*
Probability of deep inversion	*80%*	*n.a.*
Probability inversion affects rock quality	*33%*	*67%*
Probability diagenesis affects rock quality	*33%*	*67%*
Probability of tight sands from deposition	*10%*	*90%*
Probability of other negating factors	*5%*	*95%*
Chance of geological success (PG estimate)		***38%***

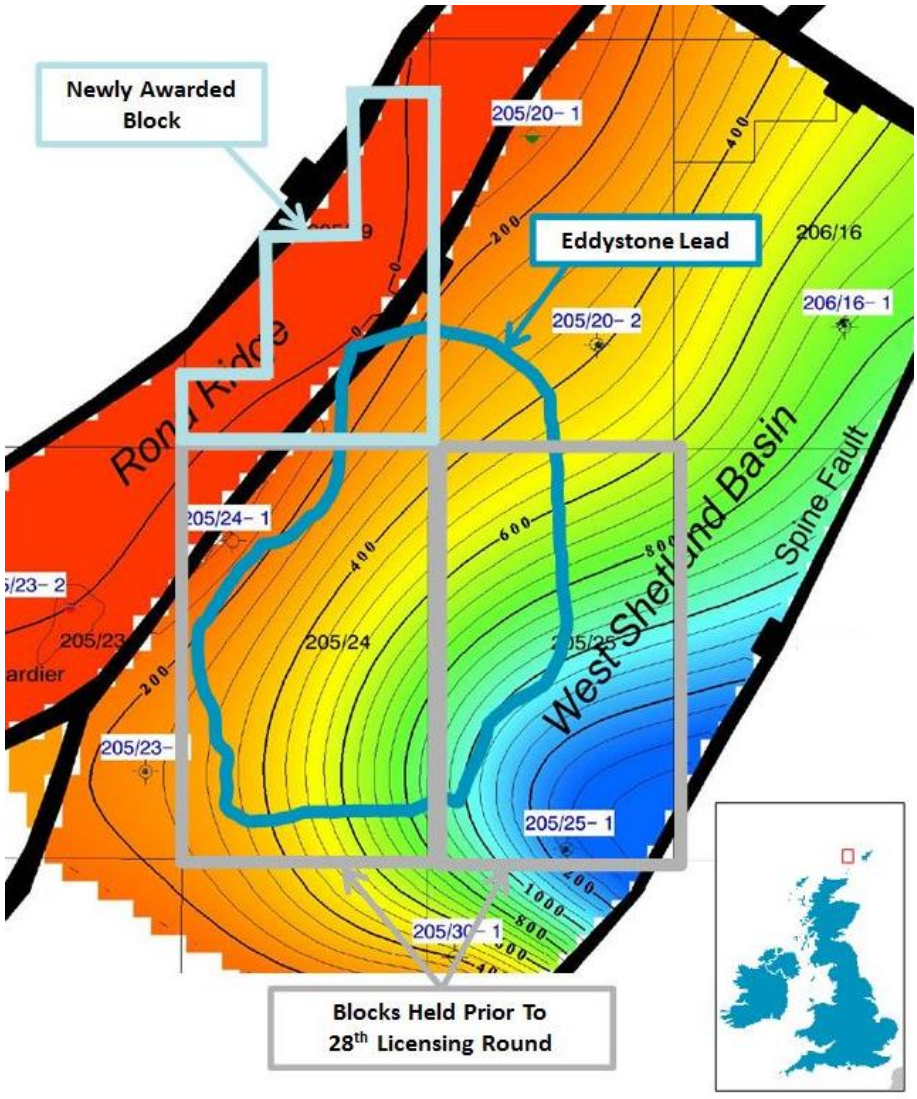
Source *Panmure Gordon*

- **Contribution to our target price:** We have not increased our target price to reflect the very positive award of Block 48/8b because we do not think it is appropriate for the equity market to pay for exploration prospects unless there is a publicly known intent/commitment to drill the relevant wells.
- **Triggers to Unlock Value:** As plans to drill a well take shape, inclusive of the detailing of a drilling schedule and the contracting of a rig, we will include prospective value for the company's Selene prospect in our target price. Ultimately, the drilling of a well has the most potential to unlock value by proving up the geological success of the prospect.
- **Licence/work program**: The licence awarded in respect of Block 48/8b is a traditional four year exploration licence with a drill or drop option. The work program consists of petrophysical analysis of key wells, a reservoir quality study and what we believe is specific detail-oriented seismic data analysis (stochastic depth conversion, an effort to map an independent Carboniferous play and seismic trace inversion for porosity on the nearby Sloop discovery). We believe that Selene is essentially ready to be drilled and we do not believe that the work program will have material incidence on the prospectivity of Selene.
- **Partners**: Block 48/8b is 50% held by Parkmead and 50% held by Atlantic Petroleum (operator).
- **Geographic Location:** Block 48/8b is circa 100 km east of Easington in the Southern North Sea. Water depths are circa 40m allowing for the use of lower cost jack-up rigs.

BLOCK 205/19B – PARKMEAD 43%, OPERATOR

The award of Block 205/19B allows Parkmead to capture an additional 13% of the Eddystone lead, bringing the P50 estimate of recoverable resources to 166 million barrels of oil. The Eddystone lead is interesting because it exhibits a bright Intra Cretaceous amplitude anomaly and there are indications that hydrocarbon generation and migration have taken place in the vicinity. Parkmead, as operator, is leading a technical programme that has potential to unearth considerable value with a very modest capital outlay. We will remain open minded about Eddystone as the company progresses with its analysis.

Eddystone Lead



Source *Parkmead, Panmure Gordon*

- **Analogue:** We believe that the nearby Edradour gas condensate discovery in Cretaceous sands increases the prospectivity of Eddystone. Edradour is operated by Total (75%) and is being developed with its co-venturer, DONG (25%). The field was discovered in 2011 and first hydrocarbons are expected to be produced in 2017 where production is expected to plateau at 17,000 boe/d. The Eddystone lead, if successful, would produce circa three times more hydrocarbons than Edradour.
- **Geological Chance of Success:** We believe that the chance of success for the prospect at this early stage is around 10%. We would expect to see the probability of success reach

the 30% mark, based on work undertaken by Parkmead, before capital is allocated to drill an exploration well on the prospect.

- **Petroleum System:** The source is thought to be Kimmeridge Clays-based. The Eddystone lead is located to the south east of the Rona Ridge, within the West Shetland Basin and is thought to lie in a migration shadow with respect to hydrocarbons generated within the Faroe-Shetland Trough. The primary target is the Cretaceous, consisting of a sequence of interbedded sandstones, limestones, siltstones and mudstones deposited in a submarine fan environment. The reservoir is expected to be sealed by a Shetland Group mudstone.
- **Licence/work programme:** The licence is a traditional four year exploration licence with a drill or drop option. A biostratigraphy study and maturity study of the West of Shetland Basin will be undertaken, in addition to reprocessing of 2,488 km of 2D seismic data.
- **Partners:** Atlantic Petroleum (43%) and Dyas (14%) are Parkmead's partners in the blocks containing the Eddystone prospect.
- **Geographic Location:** Eddystone is located circa 100 km west of the Shetland Islands in water depths of circa 350-500m.

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.

FINANCIAL STATEMENTS

Income statement (£m)

Year to June	2011A	2012A	2013A	2014A	2015E	2016E
Revenue	**3.7**	**2.9**	**4.1**	**24.7**	**16.9**	**16.1**
Cash opex	(2.0)	(1.4)	(2.1)	(12.4)	(23.7)	(12.2)
Gross profit	**1.7**	**1.5**	**2.0**	**12.3**	**(6.7)**	**3.9**
G&A costs	(5.3)	(5.5)	(7.7)	(5.7)	(1.1)	(7.0)
EBITDA	**(3.6)**	**(4.0)**	**(5.6)**	**6.6**	**(7.9)**	**(3.1)**
Depreciation	-	(0.7)	(0.7)	(9.0)	(6.3)	(6.5)
EBITA	**(3.6)**	**(4.7)**	**(6.3)**	**(2.4)**	**(14.2)**	**(9.5)**
Other	1.7	-	1.2	4.5	(13.0)	-
Financial expenses	0.0	(0.2)	(0.1)	(1.0)	0.4	(0.1)
Profit (loss) on investments	0.1	-	(0.0)	-	-	-
Income tax	(0.1)	0.0	(0.3)	0.2	2.1	(2.0)
Earnings	**(1.9)**	**(4.9)**	**(5.6)**	**1.2**	**(24.7)**	**(11.6)**

Source *Parkmead, Panmure Gordon*

Statement of changes in cash (£m)

Year to June	2011A	2012A	2013A	2014A	2015E	2016E
Earnings	(1.9)	(4.9)	(5.6)	1.2	(24.7)	(11.6)
Depreciation	0.1	0.1	0.4	9.0	6.3	6.5
Other	0.4	3.9	3.5	(1.6)	8.9	-
Deferred tax	0.0	0.0	0.3	-	(2.2)	-
Cash flow from operations	**(1.3)**	**(1.0)**	**(1.4)**	**8.7**	**(11.7)**	**(5.2)**
Changes in working capital	0.1	(1.5)	(3.4)	(2.0)	8.7	(1.0)
Cash from operations	**(1.2)**	**(2.5)**	**(4.8)**	**6.7**	**(3.0)**	**(6.2)**
Disposals	2.1	0.0	0.7	-	-	-
Investments	(0.1)	(2.9)	(8.4)	(8.6)	(13.9)	(24.9)
Cash from investments	**1.9**	**(2.9)**	**(7.6)**	**(8.6)**	**(13.9)**	**(24.9)**
Cash from equity raised	0.3	8.8	15.6	39.5	13.0	-
Net cash from debt capital	(0.0)	3.0	2.5	(4.6)	(0.1)	-
Cash from financing	**0.3**	**11.8**	**18.1**	**35.0**	**12.9**	**-**
Net change in cash	**1.0**	**6.4**	**5.6**	**33.1**	**(4.0)**	**(31.1)**

Source *Parkmead, Panmure Gordon*

Balance sheet (£m)

Year to June	2011A	2012A	2013A	2014A	2015E	2016E
Cash and equivalents	1.3	7.7	13.3	46.3	42.3	11.2
Trade receivables	1.7	3.3	4.0	11.6	3.7	4.7
Inventories	-	-	-	-	-	-
Other current assets	-	-	-	-	0.1	0.1
Investments	7.1	6.5	4.4	4.8	2.4	2.4
Long-term assets	2.3	5.5	31.7	64.7	64.4	82.9
Total assets	**12.3**	**22.9**	**53.4**	**127.4**	**112.9**	**101.2**
Trade payables	0.8	4.1	8.7	8.0	7.0	7.0
Other current liabilities	0.3	0.1	0.4	0.5	0.1	0.1
Debt	-	3.0	2.0	6.2	4.7	4.7
Long-term deferred taxes	0.0	0.0	1.6	1.6	1.5	1.5
Other long-term liabilities	2.2	3.5	3.3	11.4	13.5	13.5
Total liabilities	**3.3**	**10.7**	**16.0**	**27.7**	**26.9**	**26.9**
Equity	**9.0**	**12.3**	**37.3**	**99.7**	**86.0**	**74.4**
Liabilities and equity	**12.3**	**22.9**	**53.4**	**127.4**	**112.9**	**101.2**

Source *Parkmead, Panmure Gordon*

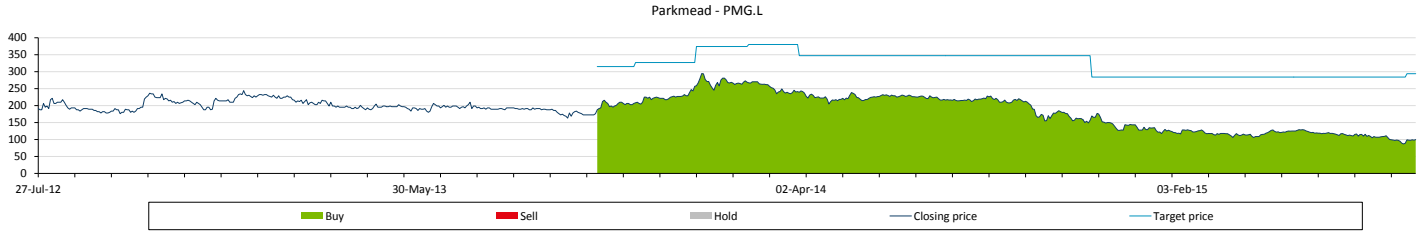
PANMURE GORDON & CO

Independent, Objective, Uncompromising

12 August 2015

Distribution of investment ratings for equity research (as of 29 Jun 15)			Rating: GUIDELINE (return targets may be modified by risk or liquidity issues)	
Overall Global Distribution (Banking Client*)			**Buy**	Total return of >10% in next 12 months
Buy	**Hold**	**Sell**	**Hold**	Total return >-10% and <+10% in next 12 months
68% (38%)	24% (5%)	8% (0%)	**Sell**	Total return <-10% in next 12 months

* Indicates the percentage of each category in the overall distribution that were banking and/or corporate broking clients



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