Hitting pay dirt
Investors Chronicle
Simon Thompson
09/04/2018

Investors are starting to warm to the investment case of Parkmead Group (PMG:41p), a small-cap oil and gas exploration and development company led by 19 per cent shareholder Tom Cross, the founder and former chief executive of Dana Petroleum. The share price has risen by 10 per cent since I included the shares in my 2018 Bargain Shares Portfolio, and recent developments only reinforce my positive stance.

For starters, the company's market capitalisation of £40.5m is still 38 per cent below IFRS net asset value (NAV) of £65.2m, even though Parkmead holds £24.4m in cash and has oil and gas interests spanning 26 exploration and production blocks in the North Sea. It also owns a £4.7m stake in Faroe Petroleum (FPM:121.5p), another oil explorer I am keen on.

Indeed, Faroe's share price gushed up 15 per cent after I published my article a fortnight ago ('Profit from corporate activity', 26 Mar 2018) on news of stakebuilding by DNO ASA, the Norwegian oil and gas operator, and significant discoveries in both the Hades and Iris prospects in licence PL 644 B, located in the Norwegian Sea and in which Faroe has a 20 per cent equity interest. There could be more exploration upside as drilling on the Rungne (Faroe-operated), Cassidy and Pabow wells are all planned for later this year, offering catalysts to narrow Faroe's share price gap to analysts' risked NAV forecasts of 141p.

Interestingly, DNO holds interests in 19 exploration licences offshore Norway and the UK, and is pursuing strategic investments and partnerships with established North Sea players. Last week, DNO snapped up a 27.3 per cent stake in Faroe at 125p a share, attracted by a combination of Faroe's daily production, which averaged 14,300 barrels of oil equivalent (boe) last year, and the value of its stated 2P reserves of 97.7m boe and 2C resources of 78.6m boe.

DNO's interest in Faroe is clearly good news for the value of Parkmead's shareholding in more ways than one. That's because Parkmead has established a key position in the UK Central North Sea following a series of licensing round successes and strategic acquisitions. The company has interests in eight licences there, of which Faroe is invested in seven of them, including some in the Perth and Dolphin fields in the Moray Firth area, which contains very large oil fields including Piper, Claymore and Tartan. Perth and Dolphin are two substantial Upper Jurassic Claymore sandstone accumulations that have tested 32°-38° API oil at production rates of up to 6,000 barrels of oil per day (bopd) per well.

Perth and Dolphin fields

Bearing this in mind, Parkmead has increased its interests in licences P218, P588 and P2154 in the Moray Firth, which contain the Perth and Dolphin fields, from 60.5 per cent to 100 per cent to boost its 2P reserves by 17.9m barrels of oil. The company also signed an agreement with Nexen Petroleum, a subsidiary of the China National Offshore Oil Corporation, to begin a detailed engineering study for the potential commercialisation of Perth and Dolphin by way of a sub-sea development tie-back via Nexen's Scott platform that's located 10km away.

Interestingly, initial work indicates that the required modifications to Scott could be relatively limited, thus offering potential to significantly reduce capital expenditure to bring the project onstream as well as lowering operating costs. True, Parkmead's Greater Perth Area (GPA) fields have high levels of sulphur, but so does the Buzzard field in the Outer Moray Firth where Nexen is operator and has a 42 per cent interest, so the company has experience of dealing with this issue.

Moreover, Parkmead has also commissioned a new reservoir study that could potentially lead to a substantial increase in the recovery factor of oil volumes at the Perth field, which currently stand at 197m barrels of oil for core Perth and 498m barrels including the northern areas of the field. It goes without saying that the Perth and Dolphin fields are a valuable asset, representing around 60 per cent of Panmure Gordon's valuation of all the fields in Parkmead's portfolio.

My take on the aforementioned developments is that they clearly improve the chance of the GPA fields being commercialised, a factor that's not being reflected in Parkmead's share price, which is half of Panmure Gordon's risked NAV estimate of 85p a share.

I would also highlight some positive news from the Diever West gas field in the Netherlands in which Parkmead holds a 7.5 per cent interest. The field came onstream in November 2015 and averaged 5,340 barrels of oil equivalent per day (boepd) in the first six months, and has been exceeding expectations since then. In fact, in February this year the field averaged 7,833 boepd and new dynamic monitoring suggests it has around 18.6m barrels of oil equivalent of gross gas-in-place, or 108bn cubic feet. That's more than double the original estimate.

In addition, Parkmead's low-cost onshore gas portfolio includes three other fields in the Netherlands that have an average operating cost of just $10 (£7.1) per barrel of oil equivalent. The profitable gas production from Diever West, and Parkmead's wider portfolio of gas fields in the Netherlands, provide important cash flow to reduce cash burn while the company makes progress with its licences in the North Sea, any one of which has potential to create substantial investment upside for shareholders. Buy.