Bargain Shares: On the hunt for hidden small-cap gems

Investors have yet to fully appreciate the scale of last month's earnings upgrade for a UK and Netherlands focused energy group which is trading on a cash-adjusted forward PE ratio of 4.5 even though it offers short-term catalysts to spark a re-rating

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By **Simon Thompson**

- *Pre-tax profit forecast raised 87 per cent for 2022/23 financial year*
- *Kempstone Hill Wind Farm locks in 250 per cent increase to wholesale electricity price*
- *Potential for positive news flow on Greater Perth Area development farm-out process*
- *Shares trading on forward cash-adjusted PE ratio of 4.5*

Investors have yet to fully appreciate the scale of last month's earnings upgrade from **Parkmead** (PMG: 56p), a UK and Netherlands focused energy group.

Previously, house broker FinnCap had been embedding an average Dutch Title Transfer Facility (TTF) gas price of €80 per MWh into its forecasts for the 2022/23 financial year for Parkmead's low-cost onshore gas portfolio in the Netherlands. However, analyst Jonathan Wright has raised the input in his model to €125 per MWh, in line with the forward curve to June 2023. This is the key reason why Wright upgraded his full-year revenue estimate by 61 per cent to £22.6mn and almost doubled his pre-tax profit estimate from £9mn to £17.4mn.

So, after factoring in a 44 per cent corporation tax charge, this implies earnings per share (EPS) of 8.2p or more than double the 3.7p estimate FinnCap expects Parkmead to report in the coming weeks for the 2021/22 financial year. On this basis, the shares are rated on a forward price/earnings (PE) ratio of seven. However, that ignores the company's cash-rich balance sheet as Parkhead has around £20mn of net cash, a sum worth 18.3p a share. On a cash-adjusted basis, the shares are trading on a bargain basement forward PE ratio of 4.5.

It's also worth noting that although the TTF gas prices for the first and second quarters of 2023 have reversed from last summer's record highs around €340 per MWh, they are still eight times the level they were at two years ago. Furthermore, although Europe may yet be able to navigate through the coming winter, there is a major problem brewing next year when the Continent will be unable to tap Russian gas supplies to boost storage facilities ahead of the winter as was the case this year. In the absence of an end to the war in Ukraine, and Russia turning on supplies to Europe, global gas prices are likely to stay at elevated levels even factoring in demand destruction and a weak economic environment.

In other words, Parkmead's bumper revenue and profit expectations are unlikely to be a one-off. If anything, the risk to earnings forecasts is skewed to the upside given that the company doesn't hedge production, so is fully exposed to the spot price. That's worth considering given that even with the benefit of warm autumn weather, which is reducing demand, gas prices for immediate delivery are only slightly cheaper than for the first quarter next year. A cold snap could see prices surge again.

Importantly, Parkmead is not a one-trick pony. Indeed, the other reason for FinnCap's upgrade is strong UK power prices. In February 2022, the company acquired Kempstone Hill Wind Farm for £4.3mn, a renewable energy asset that generates 2.85GWh of electricity each year, enough to power 1,000 homes. It not only benefits from an attractive inflation-linked, Feed-in Tarriff until 2036, but the electricity generated is sold through a Power Purchase Agreement (PPA), so provides exposure to the large increase in wholesale electricity prices seen since the start of the Ukraine war.

Bearing this in mind, the annual PPA renegotiation locked in a near 250 per cent increase to the wholesale export electricity price. Doubling the power price in FinnCap's model more than doubles Kempstone Hill's current year cash profit to £0.64mn, or three times the profit earned in the 2021/22 financial year. Interestingly, Parkmead's management are looking at expanding the site, including the potential inclusion of solar power.

There is also potential for positive news flow on the ongoing farm-out process of Parkmead's flagship Greater Perth Area (GPA) development project, one of the North Sea's largest undeveloped oil projects ('**Profit from a North Sea farm-out', 1 August 2022**). It has scope to deliver 75-130mn boe (P50 basis) and provide value-adding volumes to surrounding infrastructure through field life extension. With UK energy security high on the agenda, and Brent crude trading above $90 a barrel, or more than double GPA's $35 a barrel operating break-even, both the economics and oil price environment are supportive for a successful farm-out.

Wright has placed a $133mn (95p a share) risked valuation on Parkmead's interest in the GPA project, or $533mn (380p) on an unrisked basis, so it forms half of the brokerage's total risked valuation of 194p a share (up from 164p). Effectively, it's in the price for free given that the combined valuation of the Netherland gas assets, wind farms and net cash are worth more than the company's market capitalisation of £61mn.

Having first suggested buying, at 37p, in my **2018 Bargain Shares Portfolio**, I believe that the shares are worth buying ahead of the forthcoming results. Buy.

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