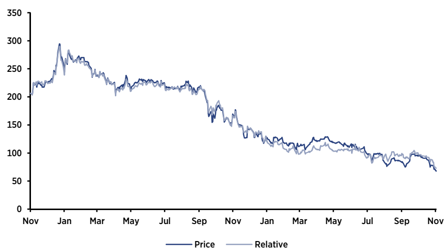
Parkmead Group (AIM: PMG LN)

BUY

Share price (as at close: 27/11/2015)	68p
Target price	163p
Upside to TP 140%	
Market cap (£m)	67.0
Net cash (£m)	41.1
Enterprise value (£m)	25.9
Shares in issue (m)	98.9
Free float (%)	62.3
Average daily vol ('000, -3m)	68
Dividend yield (%)	0.0
PER at Target price (Y1)	n/a
Sector PER	0.0
Price/book	0.8
12 month high/low (p)	177/68

(%)	1m	3m	12m
Absolute	-28.3	-21.7	-58.4
FTA relative	-27.7	-20.9	-57.5

Price & price relative (-2 year)



Source: Datastream

Next news

Diever West production update – Dec 2015

Business

Parkmead is an oil and gas company engaged in the oil and gas exploration and production.

www.parkmeadgroup.com

Sam Wahab
Research Analyst

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Research Analyst

Well capitalised and looking to grow

We initiate coverage of Parkmead with a BUY recommendation and a TP of 163p. We believe the company is well positioned to build out its European footprint through an acquisition-led growth strategy, taking advantage of low asset valuations. Concurrently, the company will organically grow its existing low-cost gas portfolio delivering additional near-term cash flows, and naturally hedging its exposure to oil price weakness.

Increasing European footprint, and diversifying production base

Despite a challenging period for the sector over the past 18 months, Parkmead has successfully grown its asset portfolio through the award of nine new licences covering a total of 12 offshore blocks in the UKCS 28th Licensing Round. These new licences contain opportunities across the Central and Southern North Sea areas, and are all operated by Parkmead. In addition, the company has successfully brought its Diever West field on-stream in the Netherlands, boosting cash flows and adding more gas into its production profile.

Key development projects progressing

Key progress has been made towards a joint development of the Perth, Dolphin and Lowlander ("PDL") fields. A Heads of Agreement was signed in August 2014 to progress the future joint development of the PDL fields. The agreement provides the framework needed to bring the enlarged project together, and outlines partner cooperation with regards to equity alignment and the future work programme. This is a significant development for Parkmead, with recoverable reserves from the oil hub development estimated at over 80MMbl - double the initial recoverable reserves of Perth as a standalone project.

Well capitalised, and ready to spend

Parkmead is well capitalised with a £41.1m cash position and no debt. In May 2015, the company raised approximately US$21.1m through a successful placing - no mean feat given the current equity market sentiment to the sector.

Initiate coverage with a BUY recommendation

Our SOTP illustrates that Parkmead currently trades at a significant discount (60%) to risked NAV. This is despite the company consistently delivering on its proposed objectives, ramping up production from its European gas assets, robust cash position, and acquisitive strategy in a distressed market. We initiate coverage with a BUY recommendation and a TP of 163p.

Year end June	Revenue (£m)	EBIT* (£m)	PBT* (£m)	Tax (%)	Adj. EPS* (p)	PER (x)	EV/EBITDA* (x)	Div yield (%)
2014A	24.7	2.1	1.0	(19.3)	1.6	42.6	2.3	0.0
2015A	18.6	(32.7)	(22.3)	(2.4)	(25.6)	(2.6)	(1.0)	0.0
2016E	24.5	(5.5)	(4.0)	10.0	(3.7)	(18.6)	(113.0)	0.0
2017E	31.7	(0.5)	0.5	10.0	0.5	143.1	7.9	0.0
2018E	32.5	0.1	0.8	1.5	0.8	81.1	9.1	0.0

* excludes exceptional items and amortisation of acquired intangibles. Source: CFE Research estimates

Investment case

Company overview

Parkmead is an AIM listed European focussed Oil & Gas producer

Parkmead is an AIM listed European focussed oil and gas producer. The company currently produces from five oil and gas fields across the UK and Netherlands and holds interests in 48 exploration and production blocks across Europe. Parkmead has significant development opportunities across the UK and Netherlands, including the Greater Perth Area development located in the Central North Sea.

Diversifying its production base creates a natural hedge

Major progress has been made this year across Parkmead's licence portfolio in the Netherlands. In September 2014, a new onshore gas field was discovered at Diever West. The Diever-2 well found gas in a good quality Rotliegendes age sandstone reservoir. A 157ft gas column was encountered, with both net pay and porosity values exceeding pre-drill expectations. The well was tested following the successful discovery and recorded an excellent flow rate of 29MMcf/d (c.5,000boepd). Diever West has been tied into existing production facilities under a fast-track and low-cost development, and first commercial gas production was achieved in November 2015. Parkmead has worked closely with the field operator, Vermilion Energy, on the fast-track development of the field and the joint-venture group successfully brought the field on-stream within just 14 months of discovery.

This effectively diversifies Parkmead's production base away from a heavy reliance on oil to generate revenues, and acts as a natural hedge for the company in terms of commodity price exposure in our view. Parkmead's gas assets in the Netherlands continue to provide a robust revenue stream and profitable net cash flows. A number of enhanced production opportunities are available across the company's existing Netherlands portfolio which it intends to capitalise on, with the aim of significantly increasing its net gas production. These include a new low-cost infill well at Geesbrug, and a further exploration target at De Mussels. The new production from Diever West and the additional Geesbrug well are forecast to more than treble Parkmead's current net gas production in the Netherlands.

Well-funded following capital raise

Parkmead is well capitalised with a £41.1m cash position

Parkmead is well capitalised with a £41.1m cash position and no debt. In May 2015, the company raised approximately US$21.1m through a successful placing of 11.2m new ordinary shares underlines continued institutional support for the management's strategy despite a challenging backdrop. The funds will be used to accelerate Parkmead's work programme and offer the company greater flexibility to take advantage of opportunities that are becoming available as a result of lower oil prices. We therefore expect the company to enter into a number of value accretive acquisitions in 2016, where robust assets are likely to be available where its poorly capitalised peers are forced into distressed sales.

Acquisitive strategy in a distressed market

The sharp decline in the oil price has led to a number of unique buying opportunities

The sharp decline in the oil price and subsequent impact on valuations of European based assets has led to a number of unique buying opportunities that Parkmead can capitalise on. We believe the slump in the crude price since June last year will speed the process of transformation in the North Sea, which will see independents playing an increasingly important role, as larger players look to divest exposure to mature fields in favour of more material assets globally. In light of this, Shell is actively reducing its exposure to mature fields in areas such as the Northern North Sea, and we have seen asset sales from other IOCs as well as NOCs. In late 2014, Faroe Petroleum (FPM LN - BUY - TP 100p) purchased two producing fields from Tullow Oil (TLW LN - SELL – TP 176p) as the latter looks to focus on its West African portfolio. Independents are able to utilise the value of their tax shields on UK production cash flows, offsetting historical losses, and therefore boosting the NPVs of these fields. This, in effect, would suggests that North Sea production remains extremely competitive on a global basis.

Further additions to portfolio increases European footprint

In November 2014, Parkmead was awarded six new licences

In November 2014, Parkmead was awarded six new licences covering a total of nine offshore blocks in the first tranche of awards under the UKCS 28th Licensing Round. These new licences contain opportunities across the Central and Southern North Sea areas, and are all operated by Parkmead. Three of the new licence awards significantly increase the company's asset base in the vicinity of its major PDL oil hub development project, which is one of the largest undeveloped oil projects in the North Sea.

This newly awarded acreage also contains exploration prospects in addition to considerable proven oil, such as the Buzzard sandstone discoveries at Polecat and Marten. Polecat was discovered in 2005 and appraised in 2010. These new strategically positioned licences have the potential to add significant value to the PDL project. In July 2015, Parkmead was awarded a further three new licences as part of the 28th Licensing Round covering three offshore blocks. Two of the new licences are located in the highly prospective West of Shetland area adjacent to existing Parkmead blocks. Detailed mapping of these blocks indicate two new exploration targets, Sanda North and Sanda South, as well as an extension of Parkmead's large Cretaceous Eddystone prospect.

The third licence award in this suite of awards is located in the Southern Gas Basin

The third licence award in this suite of awards is located in the Southern Gas Basin, an area where the company has a deep technical knowledge of the exploration plays, and is building a valuable portfolio of targets. Parkmead has already enjoyed significant success in the Southern Gas Basin with the gas discoveries at Platypus and Pharos. Seven prospects and leads have been identified on the new Southern North Sea licence with Lower Leman targets, the most important of which is a prospect called Selene.

The company's flagship PDL development continues to progress

Key progress has been made in 2015 towards a joint development of the PDL project

Key progress has been made in 2015 towards a joint development of the Perth, Dolphin and Lowlander fields. A Heads of Agreement was signed in August 2014 to progress the future joint development of the PDL fields. The agreement provides the framework needed to bring the enlarged project together, and outlines partner co-operation with regards to equity alignment and the future work programme.

Parkmead, as the PDL operator, continues to work closely with its project partners to maximise oil reserves and financial returns from the project, and from the wider regional area. The three fields are fully appraised, with 13 wells drilled, and contain oil in place of over 400MMbbl. It is expected that recoverable reserves from the PDL oil hub development will be over 80MMbbl, double the initial recoverable reserves of Perth as a standalone project.

Valuation and recommendation

Our SOTP illustrates that the shares trade at a significant discount to our risked NAV.

Our SOTP illustrates that Parkmead currently trades at a significant discount (60%) to our risked NAV. This is despite the company consistently delivering on its proposed objectives, ramping up production from its European gas assets, robust cash position, and acquisitive strategy in a distressed market.

SOTP valuation matrix

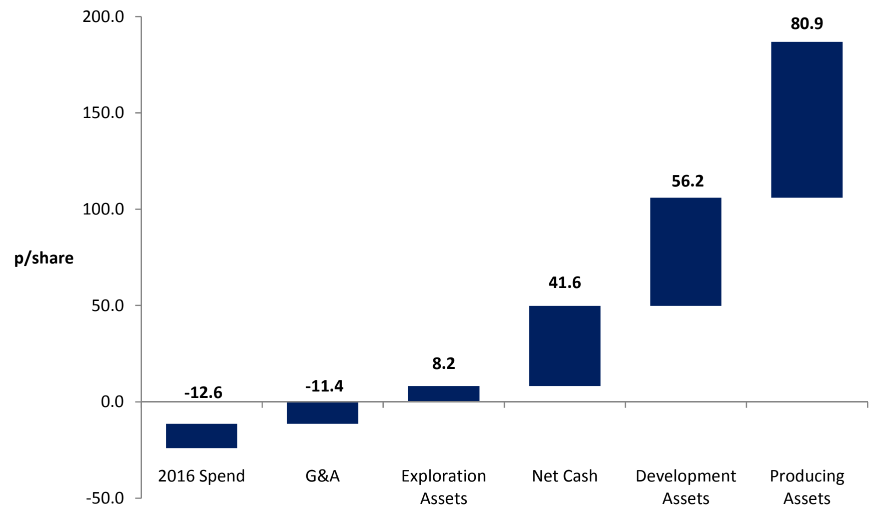
NAV	£m	p/shr
Producing/Development Assets	135.6	137.1
Net Cash	41.1	41.6
G&A	(11.3)	(11.4)
2016 Spend	(12.5)	(12.6)
Core Value	153.0	154.6
Exploration Assets	8.1	8.2
Target Mkt Cap/Price	161.1	162.8

Source: CFE Research estimates

Parkmead benefits from a strong, and growing, production profile

Parkmead benefits from a strong, and growing, production profile with an increasing emphasis on gas to act as a natural hedge against the current oil price weakness. Recently reported revenues to the end of June 2015 were £18.6m (2014: £24.7m). As expected, the significant reduction in global oil prices has in turn reduced the company's revenue during the period. During this time, the price of oil has fallen from near US$110/bbl, to seven-year lows of below US$50/bbl. This has severely impacted the revenues and cash flows of oil and gas producers globally. In response, Parkmead has worked hard to reduce operating costs across the entire asset portfolio to reflect the substantially altered macro environment.

SOTP waterfall chart



Source: CFE Research estimates

Parkmead's strong balance sheet compares favourably against its European focussed peers

With a balanced asset base, new oil and gas licences and a strong balance sheet, we believe Parkmead is well positioned to build further on its diverse portfolio of assets and to capitalise on new opportunities in Europe. In addition, bringing new gas production on-stream at Diever West in only 14 months is a significant achievement in our view, notwithstanding new licence awards in the vicinity of the major PDL project, which increases its strategic position in the region.

Valuation methodology

We value Parkmead in line with our coverage universe principally through a RENAV

We value Parkmead in line with our coverage universe principally through a RENAV. We also include a valuation of the company's respective assets and liabilities including net cash, G&A spend, and forecast capex in 2016.

We include the following assumptions:

Valuation assumptions

Metric	Unit	Assumption
Long term exchange rate	$/£	1.6
Shares in issue	m	98.93
Discount Rate	%	10%
Perth Phase 1	NPV/boe	US$5.2/bbl
Athena	NPV/boe	US$3.8/bbl
Nertherlands production	NPV/boe	US$3.2/bbl
2016 Capex spend	£m	12.5
Oil Price assumption	US$/bbl	2016: US$65/bbl, 2017+: US$75/bbl

Source: CFE Research estimates

Our RENAV takes account of the company's producing, contingent, and exploration potential in the UK North Sea and the Netherlands. Our NPV/bbl has been tempered slightly due to the current commodity price volatility, however even on our conservative approach, our risked valuation illustrates that the market undervalues Parkmead on almost every metric.

Risked net asset valuation

Country	Block	Gross Rec. Reserves	Interest	CoS/CoD	Prospective net Rec. Reserves (mmbbl)	Risked Rec. Reserves (mmbbl)	NPV 10% US$ / bbl	Unrisked NPV $MM	Risked NPV $MM	Unrisked NPV £m	Risked NPV £m	Net Risked p/shr
Production/Development												
UK	Perth Phase 1	41.0	52%	100%	21.3	21.3	5.2	110.9	110.9	69.3	69.3	70.0
UK	Athena	9.6	30%	100%	2.9	2.9	3.8	10.9	10.9	6.8	6.8	6.9
Netherlands	Netherlands Production	13.0	15%	100%	2.0	2.0	3.2	6.2	6.2	3.9	3.9	3.9
UK	Perth Phase 2	28.0	52%	50%	14.6	7.3	4.9	71.3	35.7	44.6	22.3	22.5
UK	Additional Sour Crescent upside	30.0	30%	50%	9.0	4.5	4.9	44.1	22.1	27.6	13.8	13.9
UK	Platypus	17.0	15%	50%	2.6	1.3	3.9	9.9	5.0	6.2	3.1	3.1
UK	Pharos	39.0	20%	50%	7.8	3.9	3.9	30.4	15.2	19.0	9.5	9.6
Netherlands	Ottoland	11.0	15%	75%	1.7	1.2	3.9	6.4	4.8	4.0	3.0	3.0
Netherlands	Papekop	11.0	15%	75%	1.7	1.2	5.0	8.3	6.2	5.2	3.9	3.9
		199.6			63.4	45.6		298.5	217.0	186.6	135.6	137.1
Exploration Upside												
UK	Possum	4.0	15%	10%	0.6	0.1	3.0	1.8	0.2	1.1	0.1	0.1
UK	Skerryvore	122.0	31%	10%	37.8	3.8	1.5	56.7	5.7	35.5	3.5	3.6
UK	Davaar	159.0	30%	10%	47.7	4.8	1.5	71.6	7.2	44.7	4.5	4.5
		285.0			86.1	8.6		130.1	13.0	81.3	8.1	8.2

Source: CFE Research estimates

We also include a 10 year NPV10 appraisal of the company's non-field related post-tax cash spend:

NPV10 - post tax G&A

	FY16E	FY17E	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E
G&A (post tax)	(1,701)	(1,770)	(1,841)	(1,916)	(1,993)	(2,073)	(2,157)	(2,244)	(2,335)	(2,358)
DCF @ 10% £m	(11)									
p/shr	(12.6)									

Source: CFE Research estimates

Initiate coverage with a BUY recommendation

Despite the challenges of the low oil price environment, Parkmead's focus on diversifying its production base to increase its gas weighting is commendable. Its producing Diever West field in the Netherlands will deliver profitable gas production and important additional cash flow to the company.

We initiate coverage with a BUY recommendation and TP of 163p.

We believe that Parkmead is well positioned to take advantage of the lower oil price environment and the opportunities that are arising from this. The company benefits from excellent regional expertise (validated through its drilling record), significant cash resources, and a growing low-cost gas portfolio. We therefore initiate coverage with a BUY recommendation and a TP of 163p.

Key asset overview

Parkmead currently produces c.1,800boepd from a portfolio of five oil and gas fields

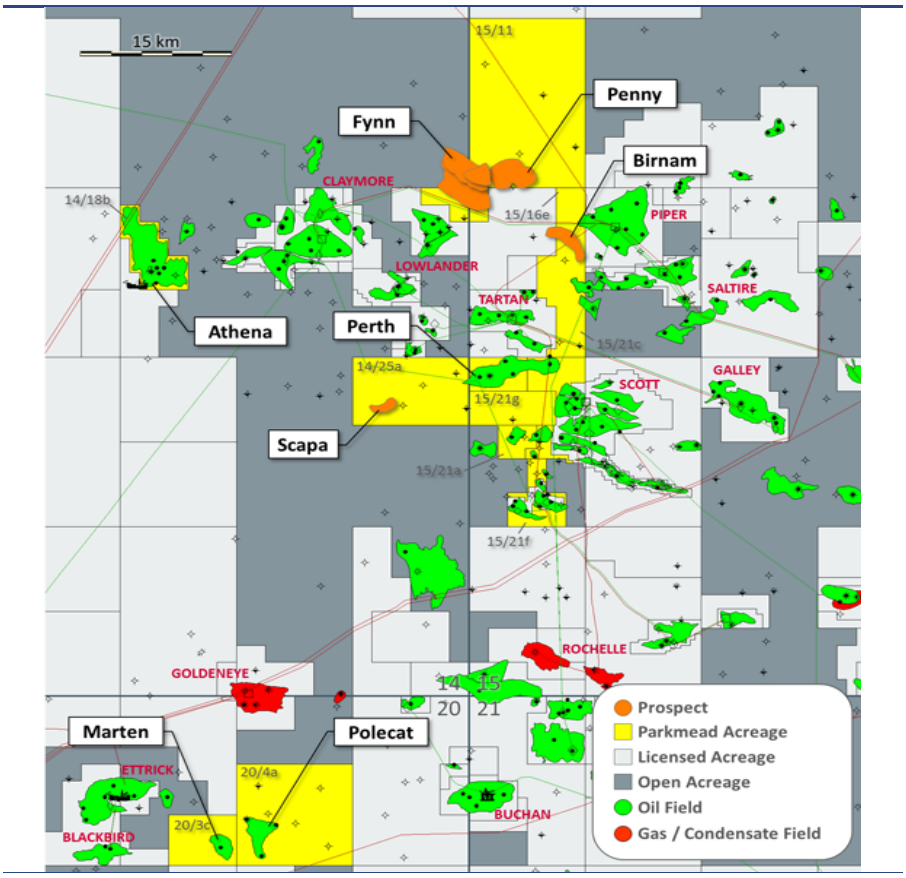
Parkmead currently produces c.1,800boepd (November 2015) from a portfolio of five oil and gas fields across the UK and the Netherlands. The company holds a 30% working interest in the Athena oil field located in the UK Outer Moray Firth and a 15% working interest in four producing onshore gas fields in the Netherlands; Geesbrug, Brakel, Grolloo, and Diever West. The Diever West gas field commenced production in November 2015, and is where the company will look to ramp up its gas output further in 2016.

UK North Sea

UK Outer Moray Firth

Parkmead holds a significant position in the prolific UK Outer Moray Firth, an area which contains major North Sea oil fields such as Athena, Piper, Claymore, Tartan and its Perth Dolphin Lowlander ("PDL") development. This position has been established both through licensing round success and strategic acquisitions.

Parkmead's exposure to the Outer Moray Firth



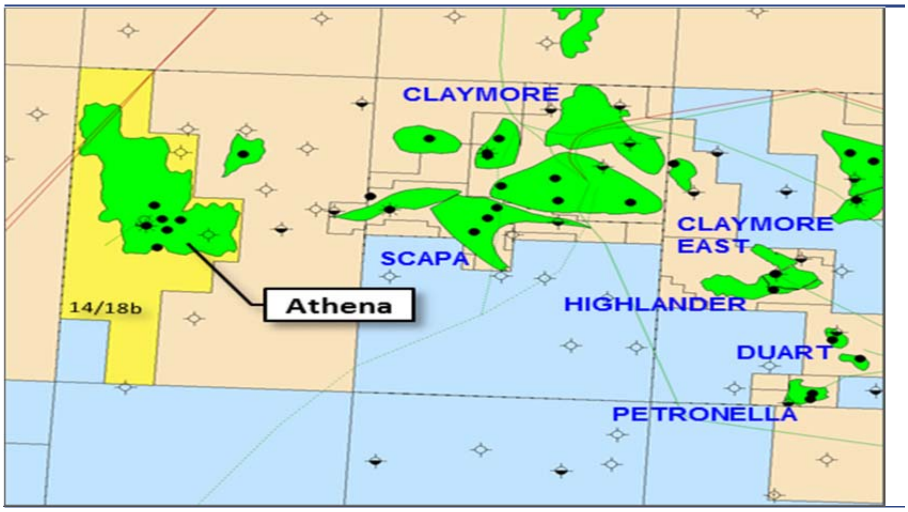
Source: Company data

Athena Oil Field

Parkmead also holds a 30% working interest in the producing Athena oil field

Parkmead also holds a 30% working interest in the producing Athena oil field. The field is situated in block 14 / 18b in the Outer Moray Firth area of the UK Continental Shelf, approximately 18km west of the producing Claymore and Scapa oil fields. The company acquired this interest through two acquisitions; the purchase of Lochard Energy in 2013, and the acquisition of a further 20% interest in the field from EWE in 2014.

Athena field location



Source: Company data

The Athena field development consists of four production wells

The Athena field development consists of four production wells, fitted with electrical submersible pumps, and supported by a water injection well that is designed to supplement natural aquifer influx.

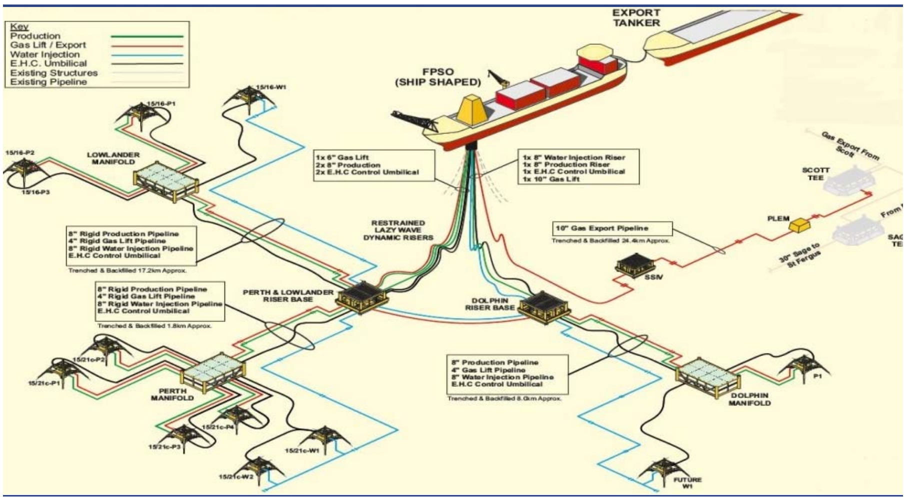
The wells are tied back to a floating production, storage and offloading ("FPSO") vessel, the BW Athena, which is moored over the field. Stabilised crude oil is transported from the FPSO by shuttle tankers directly to the Ithaca-operated Nigg oil terminal for aggregation of the crude in to larger cargoes for subsequent sale to market. Current gross production from the field is c.4,000bopd, and is therefore the largest contributor to Parkmead's overall production base.

Perth Dolphin Lowlander (PDL) project

The PDL project is one of the largest undeveloped oil projects in the North Sea

The Parkmead-operated PDL project is one of the largest undeveloped oil projects in the North Sea. The company's working interest in the Perth field came through the acquisition of DEO Petroleum plc in 2012. During 2014, a joint development study was carried out to assess the potential of a joint development of the Lowlander field with Perth. The analysis indicated that a joint project of the two fields could significantly increase the value of the Perth project. In terms of the potential upside that could be exploited at PDL, it is expected that on a gross level, the partners could recover 80MMbo, with an in-place estimate of 400MMbo.

PDL development concept



Source: Company data

Further acreage was acquired in the area through successful licensing round awards. Block 15/16e containing the Birnam prospect was awarded to Parkmead in the UK 27th Licensing Round. Two additional licences were awarded to Parkmead in the UK 28th Licensing Round, containing the Polecat and Marten oil discoveries to the south west of Perth, and the Fynn and Penny prospects to the north.

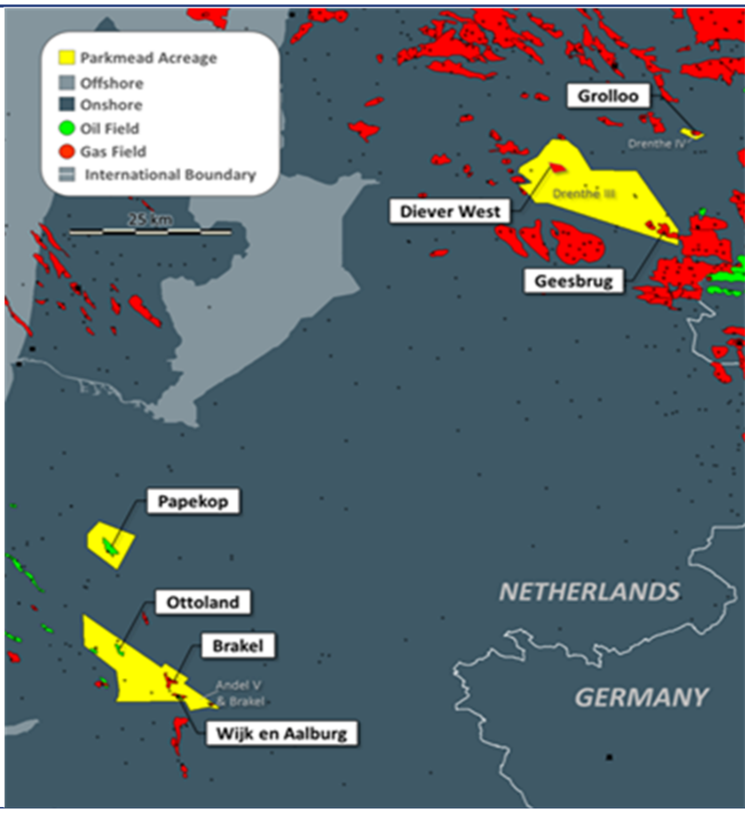
Netherlands

Parkmead holds equity in four licences in the Netherlands

Parkmead holds equity in four licences in the Netherlands which include; four producing gas fields, three oil & gas developments and a number of exploration prospects.

Gas is currently produced from the Brakel, Grolloo, Geesbrug and most recently the Diever West field. Diever West was successfully discovered in September 2014 and developed to production in only 14 months.

Parkmead's Netherlands acreage



Source: Company data

Diever West has been tied into existing facilities under a fast-track development

Diever West has been tied into existing production facilities under a fast-track and low-cost development, and first commercial gas production was achieved in November 2015. Parkmead has worked closely with the field operator, Vermilion Energy, (VET CN - NC) on the fast-track development of the field.

This effectively diversifies Parkmead's production base away from a heavy historical reliance on oil to generate revenues, and acts as a natural hedge for the company in terms of commodity price exposure. Parkmead's gas assets in the Netherlands continue to provide a robust revenue stream and net cash flows to the company. A number of enhanced production opportunities are available across its existing Netherlands portfolio which the company intends to capitalise on, with the aim of significantly increasing its net gas production. These include a new low-cost infill well at Geesbrug, and a further exploration target at De Mussels. The new production from Diever West and the additional Geesbrug well are forecast to more than treble Parkmead's net gas production in the Netherlands.

Appendix 1 – Management

Thomas Cross – Executive Chairman

Tom is a Chartered Director and petroleum engineer with extensive energy sector experience, spanning projects in more than 20 countries. Tom was the founder and Chief Executive of Dana Petroleum plc through until its sale to the Korea National Oil Corporation in 2010. Prior to Dana, he held senior positions with Conoco, Thomson North Sea, Louisiana Land and Exploration and was Director of Engineering at the UK Petroleum Science and Technology Institute. Tom is a former Chairman of BRINDEX, the Association of British Independent Oil Companies, a former adviser to the BBC on energy affairs and a Fellow of the Institute of Directors.

Ryan Stroulger – Finance Director

Ryan served as Commercial Director of the Group before becoming Finance Director. He has been responsible for identifying and driving forward numerous asset and corporate opportunities, such as the acquisitions of DEO Petroleum plc and Lochard Energy Group PLC. Prior to this, he served as Group Finance Manager, responsible for all aspects of Parkmead's external financing, from strategic planning through to successful execution. He is a member of the UK's Institute of Directors (IoD) and was awarded the Corporate Finance Qualification by the Institute of Chartered Accountants in England and Wales (ICAEW).

Colin Percival – Technical Director

Colin has more than 30 years of experience in the oil & gas industry. He began his career as a sedimentologist with BP in international operations and went on to lead a series of BP exploration teams evaluating various plays across the UKCS, which resulted in a number of significant discoveries. Colin was a member of the Dana Petroleum plc management team from 2003 to 2011, with responsibility for the technical work on all Dana operated assets and new ventures. He joined Parkmead in 2011, where he leads the Company's experienced exploration and technical group. Colin played a key role in Parkmead's success in the UKCS 27th and 28th Licensing Rounds.

Philip Dayer - Non-Executive Director

Philip has over 25 years of corporate finance, public company and stock market experience. He has worked with a number of prominent City institutions and advised a wide range of public companies including UK and international groups active in the oil and gas sector. Philip qualified as a Chartered Accountant and went on to gain extensive experience as Director or Head of Corporate Finance with Barclays de Zoete, Citigroup Scrimgeour Vickers, ANZ Grindlays and Société Générale. Latterly, whilst focusing on the energy sector, Philip was Director of Corporate Finance at Old Mutual Securities and Executive Director at Hoare Govett Limited. Philip was a non-executive director of Dana Petroleum plc from 2006 through to its successful sale.

Ian Rawlinson - Non-Executive Director

Ian has over 25 years of experience in the banking and investment industries and in advising public and private companies, including working with Lazard Brothers, Robert Fleming, Fleming Family & Partners and Dana Petroleum plc. Ian read law at Cambridge and was called to the Bar in 1981. From 1995 to 2000 he was a member of the senior management team of Flemings in Southern Africa, and was Chief Operating Officer of Fleming Family and Partners on its establishment in 2000. From 2005 he has held various independent appointments in the business and charitable sectors and was Executive Chairman of The Monarch Group from 2009 to 2014. Ian was a non-executive director of Dana Petroleum plc from 2005 through to its successful sale.

Appendix 2 – Risks

Exploration and production companies are, by their very nature, relatively high risk. Areas of common risk include geological, operational, commodity prices, credit, financial, political, regulatory, legal and security. Additional specific risks are outlined below.

General exploration and extraction risks

The exploration for and development of oil and gas deposits involves significant uncertainties and the company's operations, and the activities of Parkmead will be subject to all of the hazards and risks normally encountered in such activities. These hazards and risks include unusual and unexpected geological formations, storms and other climatic conditions, any one of which could result in damage to, or destruction of Parkmead's facilities, damage to life or property, environmental damage or pollution and legal liability which could have a material adverse impact on the business, operations and financial performance of the company. Although precautions to minimise risk will be taken, even a combination of careful evaluation, experience and knowledge may not eliminate all of the hazards and risks. With all natural resources operations there is uncertainty and, therefore, risk associated with operating parameters and costs resulting from the scaling up of extraction methods tested in pilot conditions. Natural resources exploration is speculative in nature and there can be no assurance that any potential deposits discovered will result in an increase in the company's reserve base.

Legal and regulatory environment

Exploration and extraction activities will inevitably be subject to various laws governing prospecting, development, production taxes, labour standards and occupational health, site safety, toxic substances and other matters. No assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail exploration, production or development. Amendments to such laws and regulations governing operations and activities of exploration and extraction, or more stringent implementation could have a material adverse impact on the business, operations and financial performance of the company.

Volatility of prices of oil and gas

Oil and gas prices are based on world supply and demand and are subject to large fluctuations in response to relatively minor changes to the demand for oil, whether the result of uncertainty or a variety of additional factors beyond the control of the company. The operating results and financial condition of any investment will depend substantially upon prevailing oil and gas prices. Historically, prices for oil and gas have fluctuated widely for many reasons.

Need for additional capital

The company may need to raise additional funds in the future in order to fully explore its interests and for other aspects of the business. Additional equity financing will be dilutive to holders of the company's then-existing ordinary shares in order to attract suitable investors at the time and could contain rights and preferences superior to the ordinary shares. Debt financing may involve restrictions on the company's financing and operating activities. In either case, additional financing may not be available to the company on acceptable terms. If the company is unable to raise additional funds as needed, the scope of its operations may be reduced and, as a result, the company may be unable to fulfil its exit plans. The company may be required to conduct further fundraising exercises in the future in order to develop its business, sustain cash resources and pursue acquisitions.

Increase in drilling costs and the availability of drilling equipment

The oil and gas industry historically has experienced periods of rapid cost increases. Increases in the cost of exploration and development would affect the company's ability to invest in prospects and to purchase or hire equipment, supplies and services. In addition, the availability of drilling rigs and other equipment and services is affected by the level and location of drilling activity around the world. An increase in drilling operations outside of the UK or in other areas of the UK may reduce the availability of equipment and services to the company. The reduced availability of equipment and services may delay its ability to exploit reserves and adversely affect the company's operations and profitability.

Significant competition

The company's competitors include the major oil and gas companies and independent oil and gas companies. The oil and gas business is highly competitive in the search for and acquisition of reserves and in the gathering and marketing of oil and gas production and in the recruitment and employment of qualified personnel. Some of the company's competitors have significantly greater financial, technical and other resources than the company and are able to devote greater resources to the development of their business. If the company is unable to successfully compete, its business will suffer.

Financial model

Income Statement

Year end June (£m)	2014A	2015A	2016E	2017E	2018E
Group revenue	24.7	18.6	24.5	31.7	32.5
Cost of sales	(21.4)	(39.4)	(27.3)	(29.5)	(29.5)
Gross profit	3.2	(20.8)	(2.9)	2.2	2.9
Total operating expenses	(1.2)	(11.9)	(2.6)	(2.7)	(2.8)
EBIT	2.1	(32.7)	(5.5)	(0.5)	0.1
Net interest/financial income/(cost)	(1.0)	1.9	1.4	1.0	0.7
Associate and Other non-op. income/(cost)	0.0	8.5	0.0	0.0	0.0
PBT	1.0	(22.3)	(4.0)	0.5	0.8
Tax	0.2	(0.5)	0.4	(0.1)	(0.0)
Effective tax rate (%)	(19.3)	(2.4)	10.0	10.0	1.5
Minorities	0.0	0.0	0.0	0.0	0.0
Earnings	1.2	(22.8)	(3.6)	0.5	0.8
EBITDA	11.4	(26.0)	(0.2)	3.3	2.8
Adjusted EBITDA*	11.1	(26.3)	(0.2)	3.3	2.8
Adjusted EBIT*	2.1	(32.7)	(5.5)	(0.5)	0.1
Adjusted PBT*	1.0	(22.3)	(4.0)	0.5	0.8
Adjusted earnings*	1.2	(22.8)	(3.6)	0.5	0.8
DPS (p)	0.0	0.0	0.0	0.0	0.0
EPS (p)	1.6	(25.6)	(3.7)	0.5	0.8
EPS [F. Dil.] (p)	1.6	(25.6)	(3.7)	0.5	0.8
EPS [Adj.]* (p)	1.6	(25.6)	(3.7)	0.5	0.8
EPS [Adj. F. Dil.]* (p)	1.6	(25.6)	(3.7)	0.5	0.8
Weighted average no. shares (m)	76.2	89.0	98.9	98.9	98.9
Fully dil. w. ave. no. shares (m)	77.7	89.0	98.9	98.9	98.9
Year end no. shares (m)	76.2	89.0	98.9	98.9	98.9

* excludes exceptional items and amortisation of acquired intangibles.

Source: Company data, CFE Research estimates

Cashflow Statement

Year end June (£m)	2014A	2015A	2016E	2017E	2018E
Operating income	2.1	(32.7)	(5.5)	(0.5)	0.1
Amortisation of acquired intangibles	0.3	0.3	0.0	0.0	0.0
Amortisation of other intangibles	0.0	0.0	0.0	0.0	0.0
Depreciation	9.0	6.4	5.2	3.8	2.7
Net change in working capital	(1.9)	14.6	(4.0)	(4.4)	(0.3)
Other	(2.5)	9.6	0.0	0.0	0.0
Operating cash flow	7.0	(1.8)	(4.2)	(1.1)	2.6
Capital expenditure	(9.7)	(12.5)	(8.0)	(8.0)	(10.5)
Investment in Other intangibles	0.9	(0.1)	(0.1)	(0.0)	(0.0)
Net interest/financial income/(cost)	0.1	0.2	0.1	0.1	0.1
Tax paid	(0.3)	(0.5)	0.1	(0.0)	(0.0)
Net acqns./disposals	1.1	0.0	0.0	0.0	0.0
Dividend paid	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Cash flow before financing	(0.9)	(14.6)	(12.1)	(9.0)	(7.8)
Proceeds from shares issued	39.5	13.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other	(4.6)	(3.9)	(1.7)	(1.7)	(1.8)
Net movement in cash/(debt)	34.1	(5.5)	(13.7)	(10.8)	(9.6)
Opening net cash/(debt)	13.3	46.3	41.1	27.4	16.6
Adjustments (Forex, etc.)	0.0	0.0	0.0	0.0	0.0
Closing net cash/(debt)	46.3	41.1	27.4	16.6	7.0

Source: Company data, CFE Research estimates

Balance Sheet

Year end June (£m)	2014A	2015A	2016E	2017E	2018E
Property plant and equipment	30.1	18.9	13.6	9.8	7.0
Goodwill and Acquired intangibles	33.4	35.8	40.8	45.8	53.3
Other intangibles	0.0	0.0	0.0	0.0	0.0
Other fixed assets	6.1	3.6	3.6	3.6	3.6
Non current assets	69.5	58.2	57.9	59.1	63.9
Stocks & WIP	0.0	0.0	0.0	0.0	0.0
Trade receivables	11.6	6.0	4.0	4.8	4.6
Cash	46.3	41.1	27.4	16.6	6.2
Other current assets	0.0	0.2	0.0	0.0	0.0
Current assets	57.9	47.3	31.4	21.4	10.9
Total assets	127.4	105.6	89.3	80.5	74.8
Trade creditors	8.0	14.6	12.6	7.4	7.3
Short term borrowings	2.1	0.4	(0.2)	(0.8)	0.0
Long term borrowings	4.2	0.0	(0.6)	(1.2)	(1.8)
Other liabilities	13.5	10.0	10.2	10.8	11.1
Total liabilities	27.7	25.1	22.1	16.3	16.7
Net assets	99.7	80.5	67.2	64.2	58.1
Issued share capital	19.4	19.5	19.5	19.5	19.5
Share premium account	75.0	87.8	87.8	87.8	87.8
Retained earnings	(20.6)	(51.3)	(64.6)	(67.6)	(73.8)
Other reserves	26.0	24.5	24.5	24.5	24.5
Minority interests	0.0	0.0	0.0	0.0	0.0
Total equity	99.7	80.5	67.2	64.2	58.1

Source: Company data, CFE Research estimates

Key Ratios

Year end June	2014A	2015A	2016E	2017E	2018E
Revenue growth (%)	n/a	(24.4)	31.3	29.7	2.3
Adj. EBITDA* growth (%)	n/a	(337.0)	(99.1)	(1,531.9)	(13.4)
Adj. EBIT* growth (%)	n/a	(1,689.6)	(83.3)	(91.2)	(128.1)
Gross margin (%)	13.1	(111.5)	(11.7)	7.0	9.0
Adj. EBITDA* margin (%)	45.0	(141.1)	(0.9)	10.3	8.8
Adj. EBIT* margin (%)	8.3	(175.5)	(22.3)	(1.5)	0.4
Gearing (%)	n/a	n/a	n/a	n/a	n/a
Interest cover (x)	2.0	n/a	n/a	n/a	n/a
Net debt/Adj. EBITDA* (x)	4.2	(1.6)	(119.4)	5.1	2.5
Dividend cover (x)	n/a	n/a	n/a	n/a	n/a
ROE (%)	1.2	(28.4)	(5.4)	0.7	1.4
ROIC (%)	12.8	(182.6)	(45.2)	5.9	7.9
ROCE (%)	12.8	(182.6)	(45.2)	5.9	7.9
Operating cash conversion (%)	61.4	6.8	1,847.3	(34.0)	90.1
Net cash conversion (%)	(70.0)	64.1	333.6	(1,930.5)	(947.9)
Net working cap / revenue (%)	(7.7)	78.4	(16.4)	(13.9)	(0.9)
Cap Ex / revenue (%)	39.3	67.1	32.7	25.2	32.4

* excludes exceptional items and amortisation of acquired intangibles.

Source: Company data, CFE Research estimates

Valuation Metrics

Year end June	2014A	2015A	2016E	2017E	2018E
PER (x)	42.6	(2.6)	(18.6)	143.1	81.1
EV / Revenue (x)	1.1	1.4	1.1	0.8	0.8
EV / Adj. EBITDA* (x)	2.3	(1.0)	(113.0)	7.9	9.1
EV / Adj. EBIT* (x)	12.6	(0.8)	(4.7)	(54.0)	192.6
EV / IC (x)	0.5	0.7	0.7	0.5	0.5
EV / Taxed Adj. EBIT* (x)	12.8	(0.8)	(4.8)	(54.9)	195.6
Yield (%)	0.0	0.0	0.0	0.0	0.0
P / CFPS (x)	(59.6)	(4.1)	(5.6)	(7.4)	(8.6)
NAV per share (p)	130.8	90.4	68.0	64.9	58.7

* excludes exceptional items and amortisation of acquired intangibles.

Source: Company data, CFE Research estimates