5 October 2012

Seismic reflections

Sentiment vs reality

Attending the recent World Independent Oil Companies Congress in London gave us the opportunity to assess both industry sentiment and investor reality up close and personal in one room, with some fascinating results. While smaller companies rightly continue to view exploration as the bedrock on which to deliver material capital growth, this was coming up against stories of difficult debt markets and capital flights to lower-risk large caps. While this should naturally play into the hands of M&A, the reality seems to be one of unrealistic bid/ask spreads. Fortunately, time does seem to be the one ally to doing a deal, but at what cost remains tantalisingly difficult to value.

Exploration still the life blood but...

There were references aplenty to the need for exploration upside to keep investors engaged – unsurprising, given this was a conference focusing generally on smaller independents. However, a colder look at the reality of investor sentiment suggests this is less so the case now than 12 months ago. While there have been some notable success stories such as Africa Oil and Ophir Energy in East Africa, high-impact exploration companies seem to be generally coming up short in the equities market, with risked exploration underpriced and dry holes harshly punished. Savvy E&Ps of course recognise this with North Sea-focused Faroe Petroleum and AIM newbie Bridge Energy both ably demonstrating the value of tax-shielded reserves and production to provide a stable foundation for an exciting exploration programme.

Valuation disconnects suggest an active M&A market but...

One striking feature of the conference was the degree of connectivity between discussions on debt finance, M&A and equities. While discussions on equities highlighted the flight to lower-risk large caps and track records, debt seemed to be a source of ongoing difficulty. In particular funding the transition from appraisal to field development was identified as a particularly tortuous phase for the growing E&P player. The confluence of these conversations often centred on the M&A market as arbiter, but with mixed views.

Spreads often unrealistically wide but time can help

While M&A buyers can naturally smell opportunities aplenty, the realities of the current capital markets appear not to be reflected in asking prices. Gulfsands Petroleum in particular highlighted this as a major reason it has been as yet unsuccessful in adding a new lobe to its business, despite a $100m war chest. In current markets you would be excused for thinking this would be easy, but it appears to be far from the case. With no one predicting a collapse in oil prices, this seems to be driving unrealistic perceptions of value even in difficult markets. However, attendees were agreed that this bid-ask spread would tighten and that M&A activity (reportedly up 10% year-to-date) would inevitably continue. But at what opportunity to cost remains something of an unknown.

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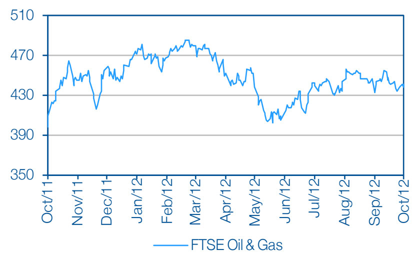

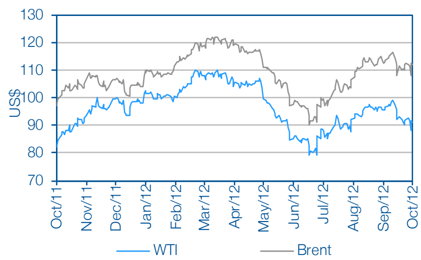

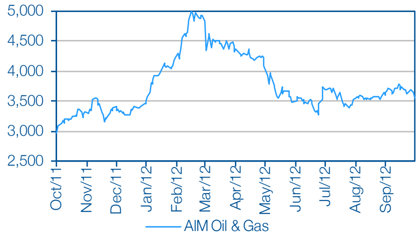

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Exhibit 1: Best and worst performers

1 week					
No.	Best performers	% change	No.	Worst performers	% change
1	SOUND OIL PLC	68.4%	1	GASOL PLC	-12.3%
2	AMERISUR RESOURCES PLC	16.1%	2	PETRONEFT RESOURCES PLC	-11.7%
3	BANKERS PETROLEUM LTD	9.8%	3	GULF KEYSTONE PETROLEUM LTD	-8.8%
4	MEDITERRANEAN OIL & GAS PLC	9.6%	4	ROCKHOPPER EXPLORATION PLC	-8.3%
5	MAX PETROLEUM PLC	8.2%	5	BORDERS & SOUTHERN PETROLEUM	-8.2%

1 month					
No.	Best performers	% change	No.	Worst performers	% change
1	NIGHTHAWK ENERGY PLC	128.1%	1	CHARIOT OIL & GAS LTD	-69.7%
2	SOUND OIL PLC	81.8%	2	RESACA EXPLOITATION-DI	-61.6%
3	PETREL RESOURCES PLC	55.6%	3	LENI GAS & OIL PLC	-35.2%
4	EUROPA OIL & GAS HOLDINGS	40.5%	4	BAHAMAS PETROLEUM CO PLC	-28.2%
5	MEDITERRANEAN OIL & GAS PLC	22.6%	5	FALKLAND OIL & GAS LTD	-27.2%

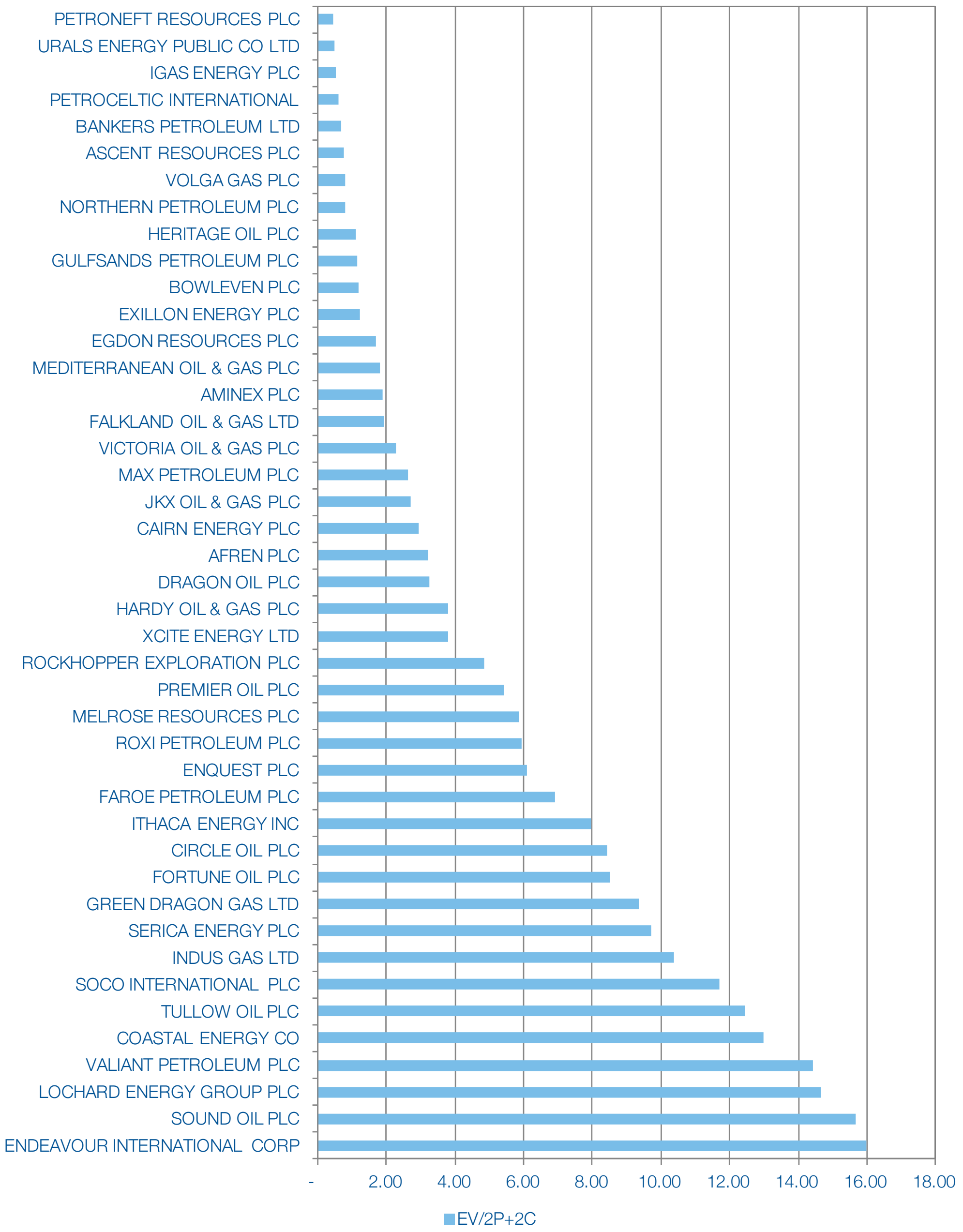
3 months					
No.	Best performers	% change	No.	Worst performers	% change
1	NIGHTHAWK ENERGY PLC	105.0%	1	CHARIOT OIL & GAS LTD	-73.0%
2	XCITE ENERGY LTD	52.1%	2	BORDERS & SOUTHERN PETROLEUM	-65.3%
3	HERITAGE OIL PLC	52.0%	3	RESACA EXPLOITATION-DI	-64.6%
4	EXILLON ENERGY PLC	47.7%	4	GASOL PLC	-60.0%
5	PETREL RESOURCES PLC	40.0%	5	FORUM ENERGY PLC	-47.3%

6 months					
No.	Best performers	% change	No.	Worst performers	% change
1	MEDITERRANEAN OIL & GAS PLC	159.1%	1	CHARIOT OIL & GAS LTD	-83.6%
2	NIGHTHAWK ENERGY PLC	88.4%	2	INDEPENDENT RESOURCES PLC	-70.5%
3	AMERISUR RESOURCES PLC	71.1%	3	RESACA EXPLOITATION-DI	-67.1%
4	IGAS ENERGY PLC	58.8%	4	BORDERS & SOUTHERN PETROLEUM	-66.9%
5	HERITAGE OIL PLC	32.3%	5	MAX PETROLEUM PLC	-65.8%

1 year					
No.	Best performers	% change	No.	Worst performers	% change
1	AMERISUR RESOURCES PLC	286.0%	1	RESACA EXPLOITATION-DI	-82.9%
2	KEA PETROLEUM PLC	108.3%	2	PETRO MATAD LTD	-74.6%
3	SERICA ENERGY PLC	100.8%	3	CHARIOT OIL & GAS LTD	-73.5%
4	COASTAL ENERGY CO	98.2%	4	LENI GAS & OIL PLC	-67.5%
5	MEDITERRANEAN OIL & GAS PLC	86.9%	5	FRONTERA RESOURCES CORP	-66.8%

Source: Bloomberg

Exhibit 2: EV/2P + 2C rankings



Source: Bloomberg, company releases, Edison Investment Research