

# Seismic reflections

## Singing those 100% equity blues

Junior oil and gas companies with large equity positions in prized assets offer investors plenty of upside when things go well. However, markets often do not value this potential, and in some cases penalise the junior for what is viewed as a high-risk strategy. Development risk and access to funding are often key to this discount. However, farm-ins also confirm the value industry partners are willing to give to assets “in the ground”, while adding a sense check to decision making. Without this, some juniors may continue to suffer to get the recognition their assets quite possibly deserve.

### Quality assets yield best farm-out terms

At a recent junior oil and gas conference in London, one of the distinguished CEOs presenting talked about the appetite that exists within the industry for good-quality assets. In short, “Quality assets will yield the best terms” when it comes to farm-outs. But this then begs the question, do high retained equity stakes indicate poorer quality assets? Or are some smaller companies simply playing it smart by retaining near 100% interests in their prime real-estate to leverage upside through the appraisal and development phase?

### 100% development curse

Two companies that currently retain 100% interests in their flagship assets are [Xcite Energy](#) with Bentley and [Rockhopper Exploration](#) with Sea Lion. In both cases these companies trade at surprisingly low EV/bbl resource ratios when compared with “peers”. Xcite trades at \$3.1/bbl of Bentley core reserves and resources, while, Rockhopper languishes at a paltry \$1.9/bbl of company estimated resources for Sea Lion, despite a highly successful appraisal programme. Rockhopper is still five years from first oil and a data room to attract farm-in partners will open shortly. But Xcite is potentially less than 12 months from first oil and its share price remains stubbornly low. So what is holding back performance for these companies?

### Farm-ins confirm value and provide a sense check

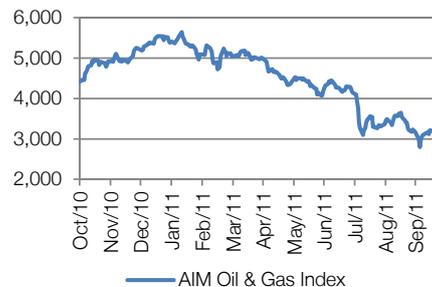
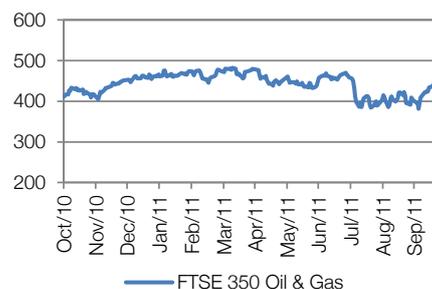
Undoubtedly some of the market reticence is linked to questions around funding and development risk. But also lurking in the background are perhaps questions around asset quality. Whether these issues are founded or not is not the point. Unless a quality partner has put their money where their mouth is and farmed in after seeing what is in a data room, one is perhaps left wondering what really is the value of some of these prized assets. Farm-outs both confirm this value, and provide a valuable sense check on decisions taken by another partner. Running with a high equity position post exploration is clearly a high risk strategy, but whether juniors really do benefit from this via leveraged upside is not always clear.



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**Exhibit 1: Best and worst performers**

		1 week			
No.	Best performers	% change	No.	Worst performers	% change
1	SOUND OIL	46.4%	1	PETRO MATAD	(15.6%)
2	PETRONFT RESOURCES	35.2%	2	GREEN DRAGON GAS	(10.9%)
3	LENI GAS AND OIL	27.5%	3	PETREL RESOURCES	(9.4%)
4	MELROSE RESOURCES	21.6%	4	GASOL PLC	(8.7%)
5	BANKERS PETROLEUM LTD	19.8%	5	LOCHARD ENERGY GROUP PLC	(7.3%)

		1 month			
No.	Best performers	% change	No.	Worst performers	% change
1	ENCORE OIL	62%	1	AMINEX PLC	(46.7%)
2	DOMINION PETROLEUM	55%	2	PETRO MATAD	(38.6%)
3	PETROCELTIC INTERNATIONAL	44%	3	RESACA EXPLOITATION INC	(31.6%)
4	SOUND OIL	41%	4	TOWER RESOURCES	(29.9%)
5	EXILLON ENERGY	34%	5	NIGHTHAWK ENERGY	(25.7%)

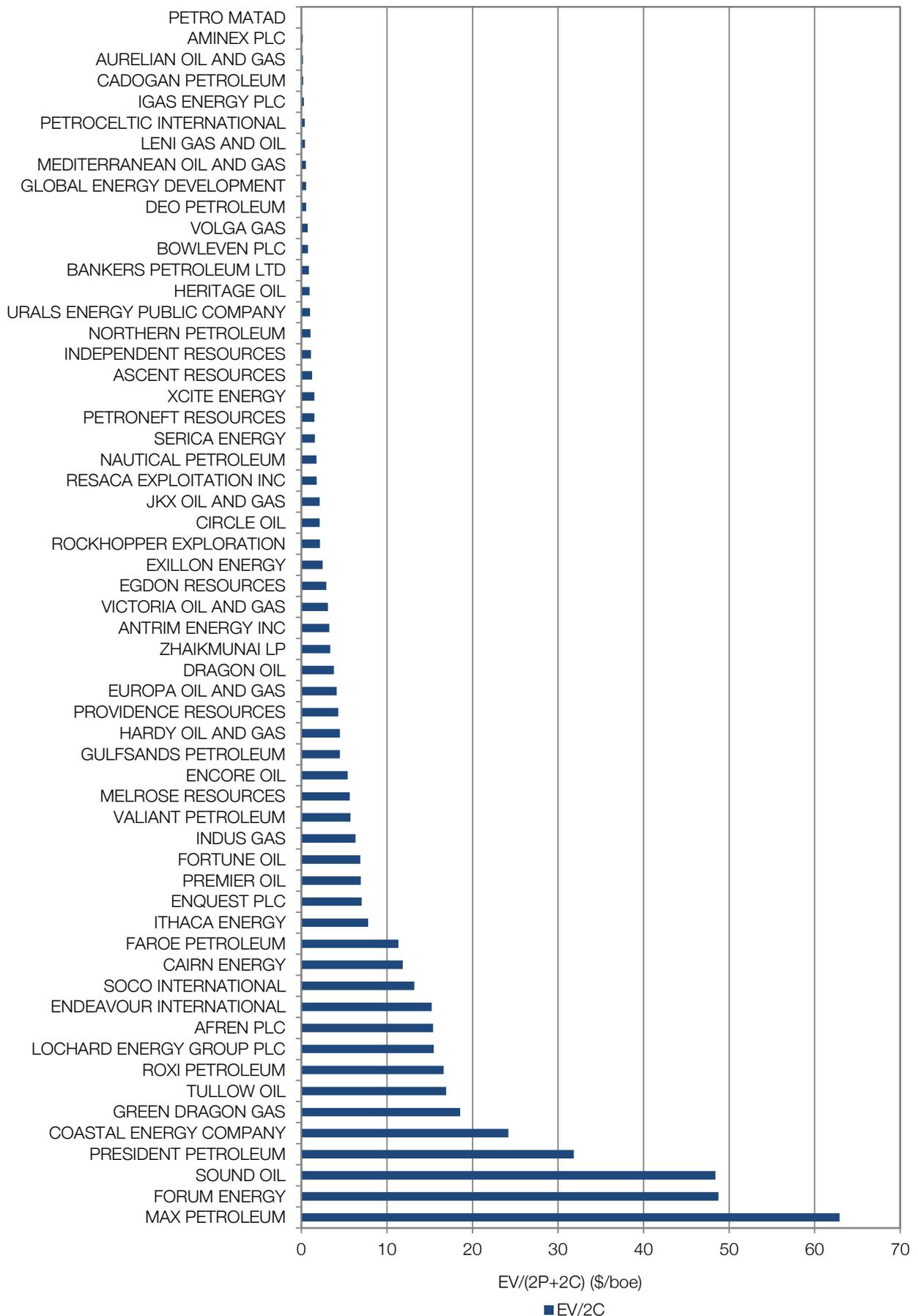
		3 months			
No.	Best performers	% change	No.	Worst performers	% change
1	DOMINION PETROLEUM	30.4%	1	PETRO MATAD	(77.0%)
2	COASTAL ENERGY COMPANY	30.3%	2	AURELIAN OIL AND GAS	(71.9%)
3	ENCORE OIL	30.2%	3	BOWLEVEN PLC	(61.2%)
4	SOUND OIL	20.6%	4	FRONTERA RESOURCES CORPORATION	(60.0%)
5	TULLOW OIL	17.1%	5	AMINEX PLC	(57.5%)

		6 months			
No.	Best performers	% change	No.	Worst performers	% change
1	COASTAL ENERGY COMPANY	93.0%	1	PETRO MATAD	(88.3%)
2	DESIRE PETROLEUM	53.7%	2	AURELIAN OIL AND GAS	(73.4%)
3	PRESIDENT PETROLEUM	30.3%	3	FRONTERA RESOURCES CORPORATION	(72.4%)
4	GLOBAL ENERGY DEVELOPMENT	30.3%	4	BOWLEVEN PLC	(65.3%)
5	INDEPENDENT RESOURCES	22.5%	5	AMINEX PLC	(64.2%)

		1 year			
No.	Best performers	% change	No.	Worst performers	% change
1	COASTAL ENERGY COMPANY	184.0%	1	PETRO MATAD	(82.9%)
2	CADOGAN PETROLEUM	114.1%	2	DESIRE PETROLEUM	(77.1%)
3	SOUND OIL	89.2%	3	FRONTERA RESOURCES CORPORATION	(77.0%)
4	RANGE RESOURCES	88.8%	4	NIGHTHAWK ENERGY	(74.0%)
5	GLOBAL ENERGY DEVELOPMENT	64.2%	5	AURELIAN OIL AND GAS	(69.3%)

Source: Bloomberg

**Exhibit 2: EV/2P + 2C rankings**



Source: Bloomberg, company releases, Edison Investment Research

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