EQUITY RESEARCH

OIL & GAS

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PROVIDENCE RESOURCES

01 OCTOBER 2018 17:12 BST - PRODUCTION
02 OCTOBER 2018 08:22 BST - DISSEMINATION

BUY

Bloomberg	ticker	PVR LN
Share price	p/shr	17.1
Target	p/shr	50
TP upside	%	192%
Shares out	Million	597.7
Fd shares	Million	656.9
Mkt cap	US$m	133.9
EV	US$m	116.3

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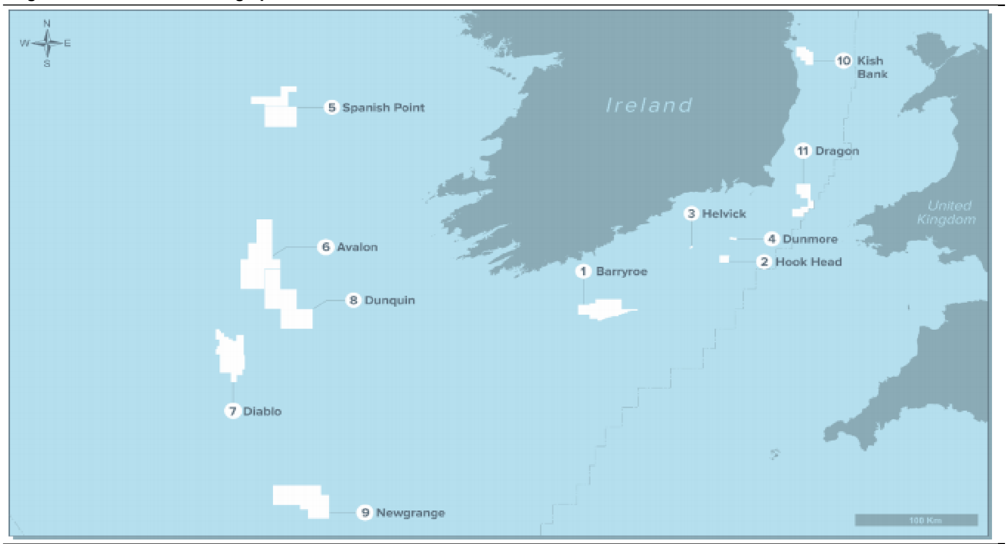
On the road to riches

The recent signing of the farm out agreement to APEC was a major step towards commercialising Providence's 350 mmbbls (gross) Barryroe oil field. The agreement sets out the terms for an expanded, comprehensive appraisal campaign, worth an estimated US$200-250m (US$80-100m net to PVR), which is designed to both firm up recoverable volumes and gather data required for the development of the field. Unrisked, we value Providence's residual 40% stake in Barryroe at over US$1.3bn (equivalent to >150p/shr). On top of this, we expect PVR to continue to be active on the exploration front with its highly prospective acreage position potentially serving up additional drilling catalysts over the next 12 months. Still, at today's share price Providence trades only marginally above the value of its net cash, plus capex carry (totalling c.14p/shr). Accordingly, we consider the company to be in an almost unique position, offering deep value but with a clear roadmap to commercialisation, and further upside in the way of multi-billion barrel exploration alongside Major oil companies. We reiterate our BUY recommendation, with an upgraded, near term target price of 50p/shr (from 33p/shr previously). This still represents a c.50% discount to risked Core NAV alone, demonstrating the value currently offered in the market.

Figure 1: Providence acreage position offshore Ireland



Sources: Providence Resources

BARRYROE SIGN OFF

The recent approval for the farm out of Barryroe was significant on a number of counts. Firstly, despite the counterparty consortium's pedigree (including the state owned COSL and JIC Capital Management), the fact that sign-offs from both the Irish and Chinese governments were required raised concerns with regards to transaction risk – particularly over timing. As it happens, the finalisation of the deal occurred in line with the timescales outlined at the time of the deal. This is important since it gives sufficient time to plan the drilling campaign for summer next year, when the better weather is likely to contribute to more efficient drilling (well locations have already been agreed, subject to site survey slated for Q4 this year). It also illustrates the high level support for the transaction from both the Irish and Chinese governments, which will be crucial when it comes to final development sanction.

Secondly, the original farm in proposal was for three firm wells, plus any associated sidetracks, with an estimated gross capex commitment of US$100m (c.US$40m net to PVR). The final agreement saw this commitment swell substantially, with now four vertical and one horizontal sidetrack committed, and two optional horizontal sidetrack wells. The firm programme also includes a deepening of three of the vertical wells, targeting the Purbeckian and Upper Jurassic exploration formations (see Figure 3, below) which are not currently included in the field's volumetrics. There is now an upfront cash payment of US$9m, which has been paid to finance long lead items associated with next years' programme, as well as a further US$10.5m which will be paid ahead of the drilling campaign. All in, this takes APEC's committed investment to between US$200m (for the firm programme) and US$250m (including the two option wells), representing up to 2.5x the original expected financial commitment.

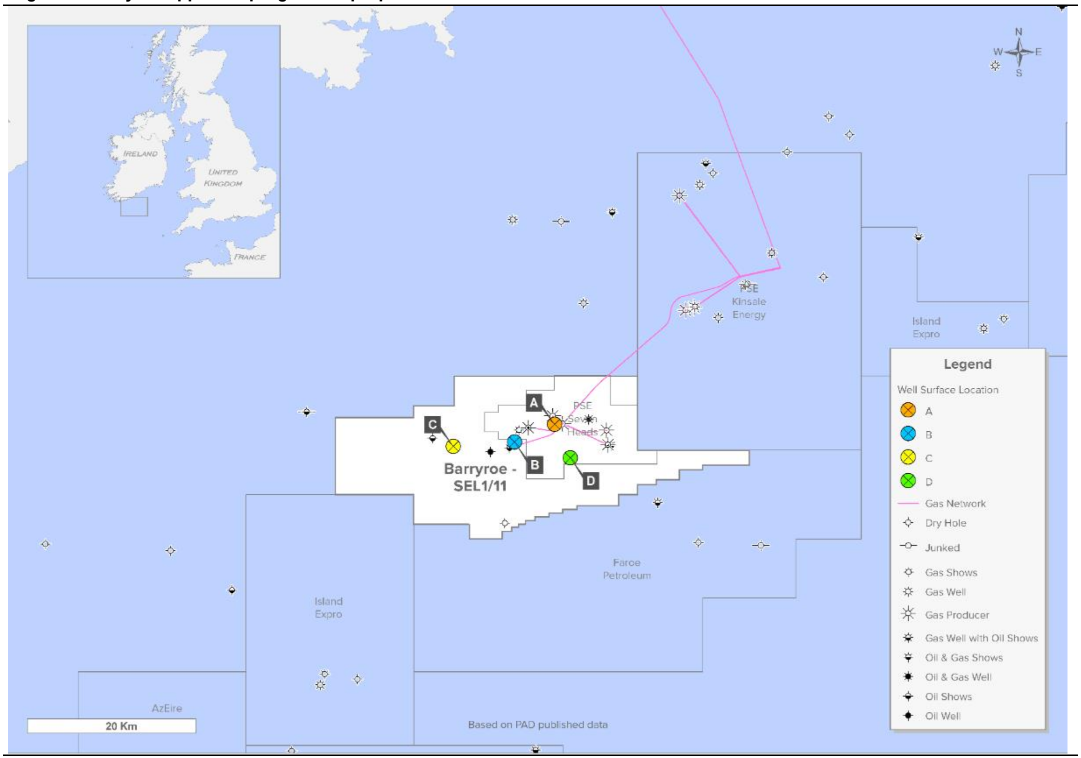
In our opinion this increased capital commitment and the nature of the work programme are clear indications of APEC's enthusiasm for the project. The four wells are designed to prove up reserves, as well as target additional volumes to the 346 mmbbls recoverable currently estimated. It also seems like development plans are already in the back of APEC's mind, with the planned horizontal wells akin to prototype producers. This will maximise the pace of the development and allow commercialisation to closely follow the appraisal phase.

In spite of the improvements to the farm in terms from PVR's perspective, the only other significant change to the deal is the assignment of San Leon's 4.5% net profits interest (NPI) in Barryroe. The NPI was originally granted by Providence during its acquisition of San Leon's 30% equity stake in Barryroe in 2011 (which increased its own interest to 80%). When the APEC deal was announced in March, we had assumed that the Chinese consortium would assume 50% of the NPI, however this is not the case, with Providence to retain the full obligation. In practice this is not onerous, with the allocation of the interest reducing our risked Core NAV by just c.9p to 101p/shr.

ANTICIPATED BARRYROE APPRAISAL CAMPAIGN

As mentioned above, we expect the first well of the campaign to spud in Q2 next year, targeting the core eastern flank of the field. The well is expected to be sidetracked, with a 200 metre horizontal section through the Basal Wealden reservoir (which accounts for c.40% of the field's current total STOIIP estimate). This horizontal well will be flow tested, and we would expect it to be designed for use as a future production well in a success case. The next three firm wells are expected to delineate the central, western and southern flanks of the field (labelled B, C and D, in Figure 2, below). In doing so, Providence expects to be able to upgrade a significant portion of the existing 2C estimates (currently totalling c.350 mmbbls) to 2P reserves. Three of the four delineation wells will also test deeper zones including the Purbeckian and Upper Jurassic, which are currently less-well understood and are excluded from the current 2C estimates, meaning further potential for incremental resource growth.

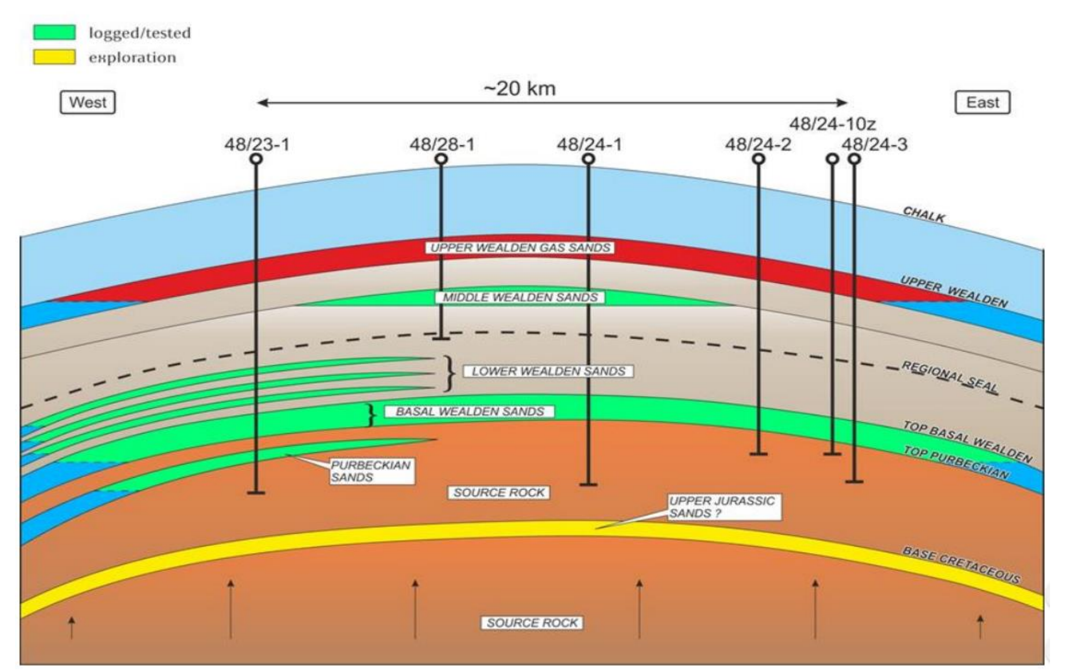
Figure 2: Barryroe appraisal programme proposed drill locations



Sources: Providence Resources

Under the terms of the revised agreement, APEC has the option to drill, test and complete an additional two horizontal wells. We understand that the two wells are likely to be drilled in the vicinity of the first well in the programme (labelled "A" in Figure 2), and on completion of testing are likely to be suspended as future production wells. Accordingly, the Barryroe partners could end the appraisal campaign having effectively already drilled three of the initial production wells required for first oil. This could significantly speed up the development of the field and allow for first oil as early as in 2021.

Figure 3: Barryroe schematic cross section



Sources: Providence Resources

DEVELOPMENT FUNDING OPTIONS

The firm appraisal programme is expected to take some 200 days excluding testing, meaning that by early 2020, the partners should have gathered sufficient data to make a final investment decision and lodge a field development plan. As mentioned above, assuming the horizontal well options are exercised, three wells will be already be drilled awaiting tie-in, meaning the bulk of the initial capex requirement will be on facilities (e.g. subsea manifolds – note we assume that the FPSO will be leased), which we estimate will cost in the region of US$250-500m (gross). With Providence retaining a 40% stake in the field, its share of upfront development capex would be just US$100-200m.

In our view the company has a number of options open to it. Firstly, at sanction the partners will have audited 2P reserves, which opens up the RBL market as a potential funding avenue. Thanks in no small part to the highly attractive fiscal terms in Ireland, Barryroe is a robust project even when stress-tested using low oil prices and high discount rates. Given the safe jurisdiction, we would expect an RBL covering a significant portion of Providence's share of capex to be available, if required.

A second option could be an extension of the financing agreement with APEC. The Chinese consortium currently charges Providence 5% plus LIBOR for the facility. This arrangement works well for both parties, given respective costs of capital, and it may be the case that APEC offers to extend the arrangement to cover at least a portion of Providence's capex share.

Finally, post farm-out Providence is left with a material 40% stake in Barryroe. Given the scale of the field, a portion of Providence's equity could be further sold down, leaving a still meaningful interest in the field. At the end of the appraisal programme, therefore, we do not expect Providence to be short of options to move the project forward to first oil.

EXPLORATION UPDATE

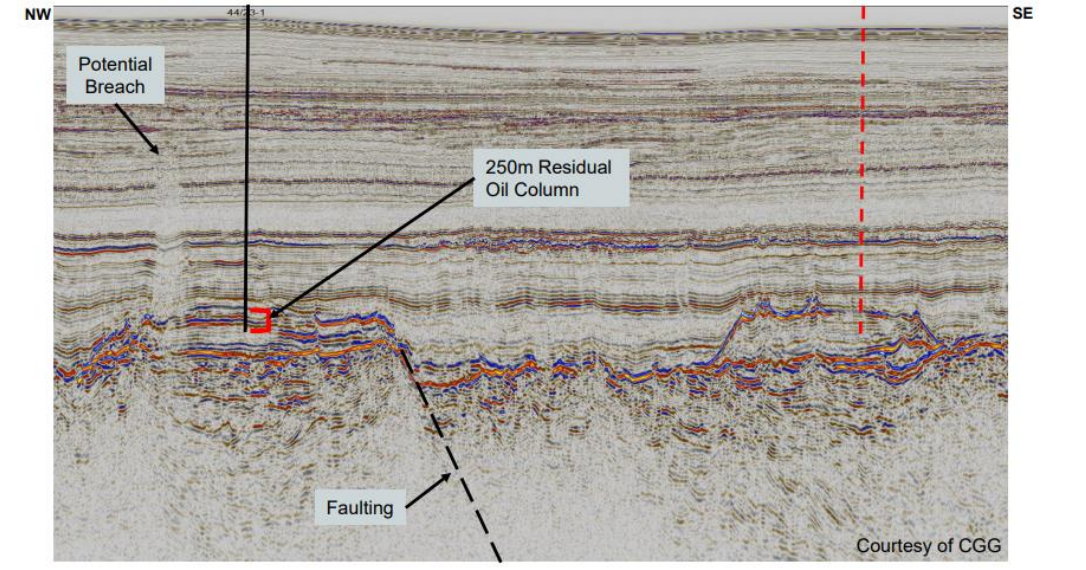
We expect Barryroe to remain front and centre to the investment case as preparations accelerate for appraisal drilling. The company will, however, continue to work up its highly prospective exploration portfolio in preparation for drilling. Earlier in the summer Providence completed a well site survey, a pre-curser to drilling, at the Newgrange prospect. Interestingly, the survey confirmed the presence of large numbers of pockmarks. As the name suggests, pockmarks are small depressions in the seabed, caused by fluids (often oil and/or gas) escaping from underlying sediments. While such features are not necessarily direct hydrocarbon indicators themselves, their sheer density (over 100 individual features over an area equivalent to less than 1% of the Newgrange structure) de-risks the presence of an active hydrocarbon source. Given its wildcat nature, the source presence is only one of a number of uncertainties which can only be tested via drilling, but the presence of pockmarks can only be positive from a technical perspective, and may prove particularly significant as farm out discussions mature.

Figure 4: Licence operators SW Ireland (PVR acreage in white)

Sources: Providence Resources

Meanwhile, Providence has recently published its first image from the recently processed new 3D seismic over the Dunquin North and South structures. The image is a broad cross-section of the two structures, and, most interestingly, clearly shows the large gas chimney which is interpreted as being the failure mechanism of Dunquin North (labelled "potential breach" in Figure 5). The partnership, which includes operator Eni, and Repsol alongside Providence, is continuing to work up the seismic ahead of a decision to drill.

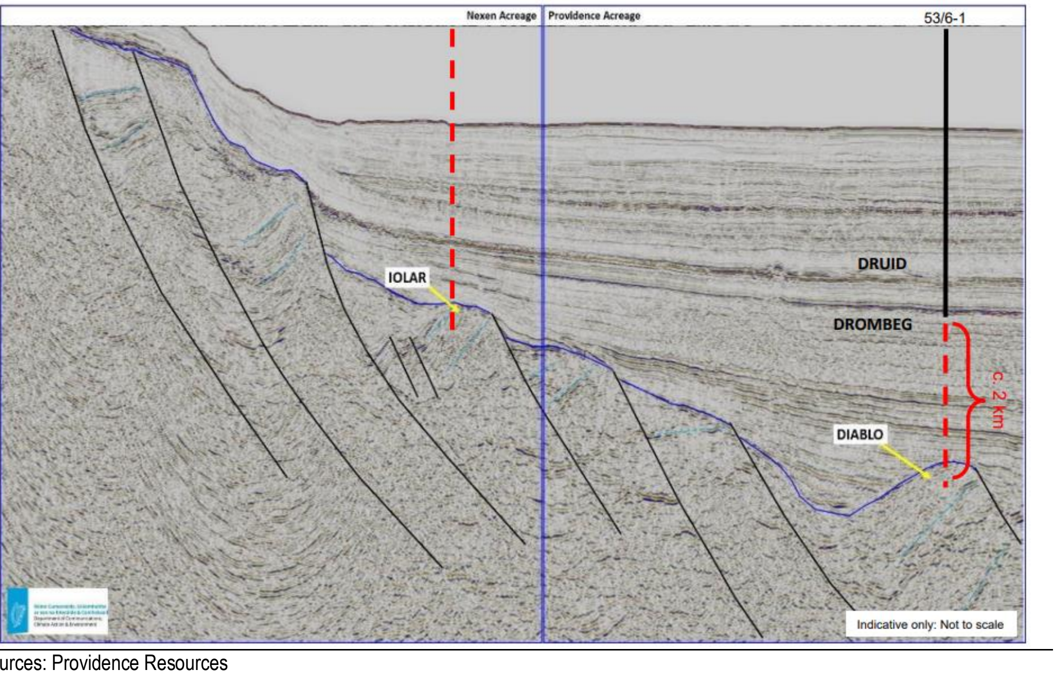
Figure 5: Seismic cross section of Dunquin North (left) and South (right)



Sources: Providence Resources

Finally licence neighbour Nexen-CNOOC is planning to bring a rig to the area during next year's summer drilling window. The well is due to test the Iolar prospect, which has direct implications for Providence and partner Total's Diablo prospect (see Figure 6, below). The well has the added significance in that a deep water rig is being mobilised to the region. Mob/demob costs are unique to each campaign, and therefore adding wells with additional contractors can help minimise the costs. The fact that a rig is in the basin already, therefore, reduces the cost of a stand-alone well, and increases the likelihood of Providence drilling its drill-ready prospect, Newgrange.

Figure 6: Seismic cross section of Iolar and Diablo prospects



Sources: Providence Resources

VALUATION IMPLICATIONS

We have updated our model to reflect the terms of the farm in, as well as the added colour around the appraisal programme and our interpretation of APEC's intentions for Barryroe. We had previously assumed that Providence would take a phased approach to the development of Barryroe, but APEC's farm in, including its assumption of operatorship during the development phase, makes a full field development more likely, in our view. Accordingly, we have modelled the full 2C resource base of 346 mmbbls, gross (note for conservatism we still omit the exploration potential in the Purbeckian and Upper Jurassic). Unrisked, we value Barryroe at US$9.5/bbl (net to Providence), implying a NAV of over 150p/shr. Factoring in an overall 64% chance of success (comprising 80% geological and commercial chances of success, respectively), we calculate a risked Core NAV of 101p/shr. As before, our Total NAV also includes a further c.40p/shr of heavily risked value attributable to the Dunquin South and Newgrange prospects.

Figure 7: Valuation summary

NET ASSET VALUE

Asset	Gross		Net		Unrisked			Risked	
	mmboe	Interest	mmboe	US$/boe	US$m	p/share	CoS	US$m	p/share
Barryroe	346	40%	138.4	9.49	1,313	152.6	64%	840.6	97.7
Net cash (debt)					9	1.1		09	1.1
Option & warrant proceeds					18	2.0		18	2.0
Core NAV	**346**		**138**		**1,340**	**155.8**		**868**	**100.8**
Dunquin South	1,389	27%	373	4.46	1,664	193.4	15%	250	29.0
Newgrange	1,360	80%	1,088	2.23	2,427	282.1	5%	121	14.1
Total NAV	**3,095**		**1,599**		**5,432**	**631.2**		**1,238**	**143.9**

Valuation assumptions:

Brent US$70/bbl flat

Discount rate 10%.

1.31 US dollar / $.

597.7 basic shares, plus 59.2m dilutive warrants = 656.9m fully diluted.

Only Dunquin South & Newgrange exploration prospects considered. Omits less mature Avalon & Diablo prospects

Source: Mirabaud Securities.

At under 20p/shr, Providence shares are clearly trading at a substantial discount to where we consider fair value. While we expect the shares to trend towards the 100-140p/shr mark, realistically we consider this a medium term objective. Accordingly, for now we are recommending a near term 50p/shr target price, on the basis that we will reconsider as we approach the start of next year's (Q2) drilling campaign. We would add that this target price offers nothing for Providence's exploration position, which we consider one of the most prospective in the sector. Any progress in readying prospects for drilling could see the share price, and our target price, upgraded accordingly.

DISCLAIMER

RECOMMENDATIONS HISTORY

Date	Market Index level	Share Price (p/shr)	Target Price (p/shr)	Opinion
28 Mar. 2018	1,169.6	9.4	33	BUY
11 May 2018	1,292.3	10.4	33	BUY
02 Oct 2018	1,320.6	17.1	50	BUY

RATINGS, CERTIFICATION AND DISCLOSURE

RATINGS SYSTEM

BUY: The stock is expected to generate absolute positive price performance of over 10% during the next 12 months.

HOLD: The stock is expected to generate absolute price performance of between negative 10% and positive 10% during the next 12 months.

SELL: The stock is expected to generate absolute negative price performance of over 10% during the next 12 months.

RISK QUALIFIER: Speculative: The stock bears significantly higher risk that typically cannot be valued by normal fundamental criteria and investment in the stock may result in material loss.

The ratings are applicable to all research produced after 1st January 2016

PROVIDENCE RESOURCES

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