

Seismic reflections

Funding troubles, M&A bubbles

Many junior developers have the assets to make the leap to full-cycle E&P with commercial resources and experienced management ready to fast track discoveries into production. However, with debt funding elusive and equity prohibitively expensive many companies are struggling to fund their developments. To overcome this some are turning to alternative options such as SEDA facilities while a more diverse portfolio allows others, such as Faroe Petroleum, to swap discoveries for production that can be leveraged for debt. But if juniors do not secure funding, share prices are likely to continue to underperform and we may see them becoming takeover targets for mid-sized cash-rich players looking to buy cheap oil in the ground.

Nimble, focused and operationally strong

The junior developer space is packed with nimble, focused and operationally strong companies. These companies have a much narrower focus than the large players, becoming specialists in their region and their product; for example, it is arguable that there are few companies more knowledgeable about the Sea Lion field than Rockhopper. With this focus and expertise, juniors offer considerable upside and have the ability to make the leap from pure exploration to full-cycle E&P player.

Funding remains elusive

However, with depressed capital markets, the sad reality is that, even with a strong portfolio, funding developments has become incredibly difficult. Gone are the halcyon days of 80-90% debt. Many companies with good development options now see 40-50% debt as a best-case scenario. More and more companies are being forced to dilute their share price to fund early-stage developments. With weak prices and large funding requirements, smaller developers are struggling to commercialise their discoveries. Investors will not invest until funding is secured, but with funding made difficult through low share prices, this is the vicious cycle holding back share prices for many junior developers.

Will 2012 be a year of consolidation?

This creates one interesting outcome, cheap oil in the ground to buy. For example, Xcite is trading at \$1.1/bbl of net resources and Rockhopper at \$2.6/bbl, well below what we would expect trade deals to be done at. These developers have commercial assets but do not have the reserves or cash flow required to raise significant levels of debt. Other than following the Faroe route, many of them could find themselves targets of mid-sized players looking to buy cheap, near-stage commercial resources in the ground. 2012 could well be a year of consolidation in the small/mid space.



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Exhibit 1: Best and worst performers

		1 week			
No.	Best performers	% change	No.	Worst performers	% change
1	DEO PETROLEUM	47.4%	1	ENCORE OIL	(13.6%)
2	GULF KEYSTONE PETROLEUM	40.1%	2	MEDITERRANEAN OIL AND GAS	(13.3%)
3	RANGE RESOURCES	25.8%	3	FALKLAND OIL AND GAS	(10.0%)
4	AMERISUR RESOURCES	20.9%	4	SERICA ENERGY	(9.9%)
5	ROXI PETROLEUM	19.4%	5	EUROPA OIL AND GAS	(9.9%)

		1 month			
No.	Best performers	% change	No.	Worst performers	% change
1	GULF KEYSTONE PETROLEUM	65.7%	1	MEDITERRANEAN OIL AND GAS	(27.8%)
2	ENEGI OIL	62.5%	2	CADOGAN PETROLEUM	(24.6%)
3	ENDEAVOUR INTERNATIONAL	54.3%	3	LOCHARD ENERGY GROUP PLC	(18.2%)
4	EUROPA OIL AND GAS	46.0%	4	JKX OIL AND GAS	(17.9%)
5	RANGE RESOURCES	34.9%	5	MAX PETROLEUM	(17.5%)

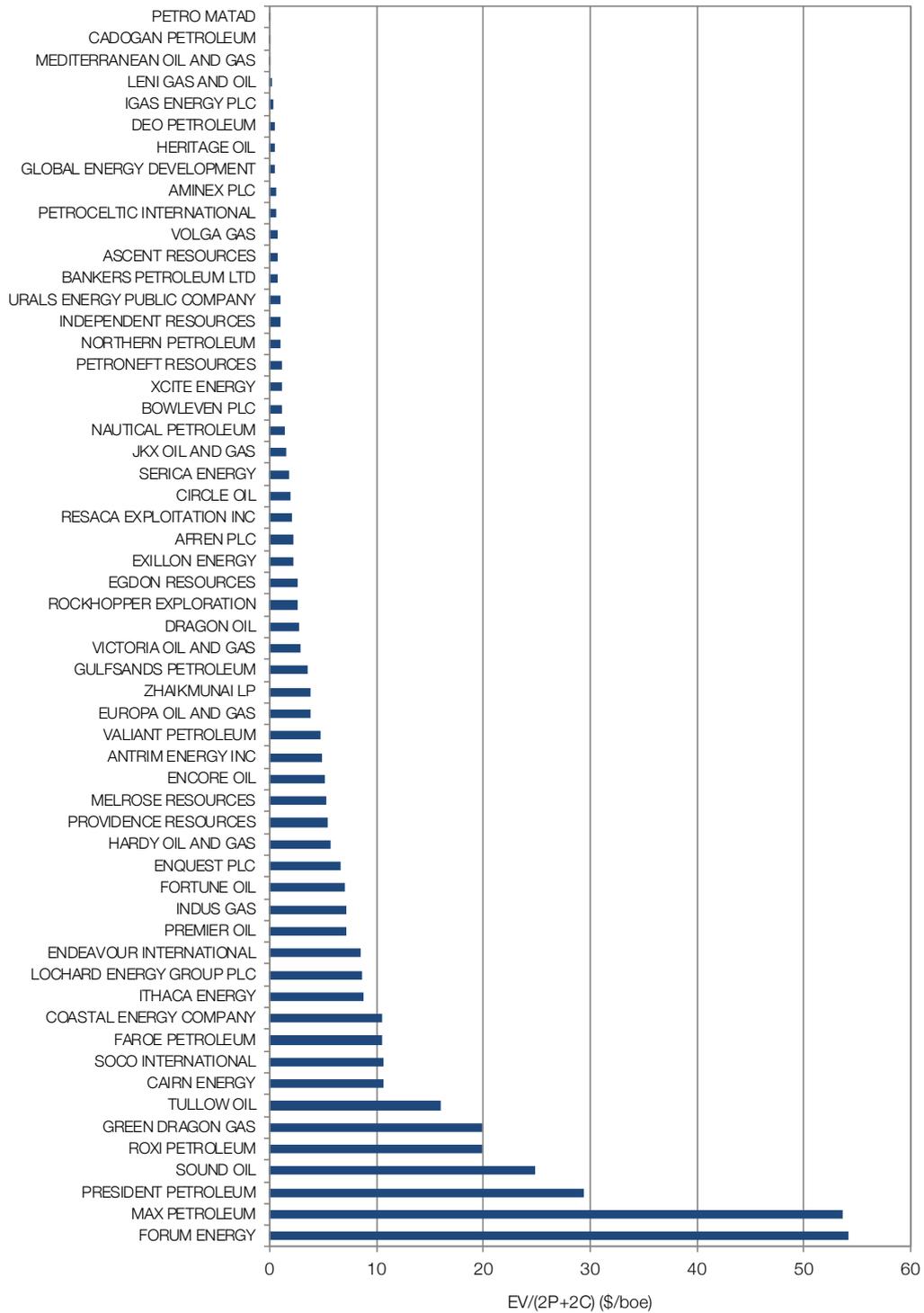
		3 months			
No.	Best performers	% change	No.	Worst performers	% change
1	GULF KEYSTONE PETROLEUM	116.7%	1	LENI GAS AND OIL	(53.3%)
2	AMERISUR RESOURCES	68.8%	2	CADOGAN PETROLEUM	(46.7%)
3	ENEGI OIL	64.8%	3	MEDITERRANEAN OIL AND GAS	(37.1%)
4	COASTAL ENERGY COMPANY	62.7%	4	LOCHARD ENERGY GROUP PLC	(33.9%)
5	PETROCELTIC INTERNATIONAL	60.7%	5	RESACA EXPLOITATION INC	(30.6%)

		6 months			
No.	Best performers	% change	No.	Worst performers	% change
1	GULF KEYSTONE PETROLEUM	101.4%	1	LENI GAS AND OIL	(81.3%)
2	COASTAL ENERGY COMPANY	88.1%	2	BOWLEVEN PLC	(74.7%)
3	DOMINION PETROLEUM	29.2%	3	AURELIAN OIL AND GAS	(71.8%)
4	BORDERS & SOUTHERN PETROL	35.1%	4	PETRO MATAD	(67.3%)
5	COVE ENERGY PLC	31.8%	5	MEDITERRANEAN OIL AND GAS	(58.5%)

		1 year			
No.	Best performers	% change	No.	Worst performers	% change
1	COASTAL ENERGY COMPANY	130.3%	1	LENI GAS AND OIL	(81.4%)
2	GULF KEYSTONE PETROLEUM	65.7%	2	BOWLEVEN PLC	(79.6%)
3	COVE ENERGY PLC	33.5%	3	MEDITERRANEAN OIL AND GAS	(78.8%)
4	RANGE RESOURCES	22.6%	4	AURELIAN OIL AND GAS	(78.8%)
5	HARDY OIL AND GAS	21.3%	5	PETREL RESOURCES	(75.8%)

Source: Bloomberg, company releases, Edison Investment Research

Exhibit 2: EV/2P + 2C rankings



Source: Bloomberg, company releases, Edison Investment Research

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