Hartleys

PCL.asx

Speculative Buy

Conventional Oil & Gas: Explorer

PANCONTINENTAL OIL AND GAS NL

Welcome to Tullow Farm

Pancontinental Oil and Gas NL (PCL, The Company) has announced that Tullow Oil (Tullow) has agreed to farm into its offshore Namibian acreage (EL0037). Whilst never a guarantee of success, we think the introduction of a company with a strong track record of exploration success offshore Africa is very positive for PCL.

Tullow to farm-in to 65% in exchange for US$130m in spend

The basic details require Tullow to free carry PCL through an extensive 2D (1000km) and 3D (3000sq km) seismic program and an optional exploration well to earn a 65% interest in EL0037. The value of the work is assumed by PCL to be in the range of US$110m-130m. PCL will retain a 30% interest in EL0037. Tullow will reimburse PCL to 65% of back costs (approximately US$500k). The seismic program must begin by December 2014 (PCL expect the seismic acquisition to begin by late 2013). Paragon Oil and Gas retain the remaining 5% interest in EL0037.

There are some unique aspects to this agreement that should be highlighted. Should Tullow choose not to proceed with the exploration well after completion of the 2D and 3D seismic program then the 65% interest will be re-assigned to PCL at no cost. To withdraw Tullow must inform PCL in writing no later than 16 months after capture of the 3D seismic data or 13 months prior to the expiry of the First Renewal Exploration Period, whichever is earliest. If we assume the seismic program is complete by end 1QCY14 then the first withdrawal deadline will be July 2015. This clause is unique to recent farm out agreements that usually include an “optional well”.

No spending cap

An important aspect of the agreement with Tullow is that there is no spending cap on the work program. In other farm out agreements a spending cap is usually set which means that when costs exceed a certain amount the junior partner (or farmor) is on the hook for cost overruns.

What else should the market look forward too?

We believe there are several catalysts that could provide further positive impetus for the PCL share price over the next 6 months. These include the farm down of an interest in the L6 concession offshore Kenya and BG drilling an exploration well on the L10A/10B (maybe two) offshore Kenya in 1Q 2014. Other news flow may include Apache reinvigorating its exploration program in the L8 block.

Valuation and recommendation

The look through value of the farm out agreement values PCL’s share in EL0037 at US$51m or 4.9 cps assuming a total deal value of $110m. We maintain our 12 month target price of 25cps and our Speculative Buy recommendation. We have raised our target price because of the quality of operator that PCL has been able to farm in. For reference the recent farm out announcement by Far Ltd (FAR) afforded investors a 37% return from the announcement date to the peak 13 days post the announcement.

6 Sep 2013

Share Price:	$0.084
12mth Price Target:	$0.25

Hartleys Brief Investment Conclusion

PCL holds a large acreage position offshore Kenya. PCL is participating in up to four wells offshore Kenya over the next 12 to 18 months. Plenty of activity in Kenya and Namibia to provide catalysts for PCL.

Key Personnel

David Kennedy	Chairman
Barry Rushworth	CEO
Ernest Myers	Finance Director

Top Shareholders:

Sundowner International Limited	11.6%

Company Address:

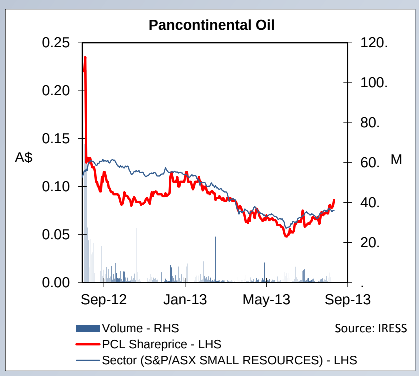
Ground Floor, 288 Stirling St
Perth, WA, 6000

Valuation:	$0.84
Issued Capital:	1151.0m
- fully diluted	1156.0m
Market Cap:	$96.7m
- fully diluted	$97.1m
Cash Equiv Jun '13):	$33.8m
Debt (Jun '13):	$0.0m

Valuation Summary

Asset	Value A$m	Risked cps	Unrisked cps
Exploration			
L8 (15%)	181.9	16	99
L6 (40%)	428.8	37	683
L10A (15%)	93.8	8	81
L10B (15%)	93.8	8	81
EL 0037 (30%)	140.7	12	489
Cash	35.3	3	3
Corporate/Other	-6.7	-0.6	5
Total	**967.5**	**84**	**1,442**

Source: Hartleys Research



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Hartleys has provided corporate advice within the past 12 months and continues to provide corporate advice to Pancontinental Oil & Gas NL, for which it has earned fees and continues to earn fees.

SUMMARY MODEL

Pancontinental Oil and Gas PCL

Share Price $0.084

6 Sep 13
Speculative Buy

Key Market Information	
Share Price	**$0.084**
Market Capitalisation	$97m
Net Debt (cash)	-$33.8m
Issued Capital	1151.0m
ITM options	0.0m
Options	5.0m @ A$0.13
Issued Capital (fully diluted ITM options)	1151.0m
Issued Capital (fully diluted all options)	1156.0m
EV	$62.9m
Valuation	**$0.84**
12Mth Price Target	**$0.25**

Directors	Company Details
David Kennedy	Chairman
Barry Rushworth	CEO
Ernest Myers	Finance Director

Top Shareholders	m shs	%
Sundowner International Limited	134.1	11.6%

Projects	Interest	Location	Commodity
L6	40%	Kenya	Oil/Gas
L8	15%	Kenya	Oil/Gas
L10A	15%	Kenya	Oil/Gas
L10B	15%	Kenya	Oil/Gas
EL0037	30%	Namibia	Oil/Gas

Investment Summary

Pancontinental has a large acreage position offshore Kenya and Namibia. The Company has managed to partner with the likes of Apache, BG and Tullow to explore for large scale, commercial oil and gas reservoirs.

Expected News flow		Project
4Q 13	Farm down of L6	Kenya
4Q 13	Results from Anadarko well	Kenya
4Q 13	Seismic program	Kenya
1Q 14	BG well in L10A/10B	Kenya
1Q 14	Seismic program (Tullow)	Namibia

Resources	Oil mmbbl	Gas bcf	Condensate mmbbl	Oil Eq mmbbl
P50				
EL0037	2,345	-	-	2,345
L6	1,502	-	-	1,502

P&L	FY2013F	FY2014F	FY2015F
Net Revenue	na	na	na
Total Costs	na	na	na
EBITDA	na	na	na
Deprec/Amort	na	na	na
EBIT	na	na	na
Net Interest	na	na	na
Pre-Tax Profit	na	na	na
Tax Expense	na	na	na
NPAT	loss	loss	loss
Abnormal Items	na	na	na
Reported Profit	loss	loss	loss

Unpaid Capital	No (m)	$ (m)	Ave Pr	% Ord
30-Jun-15	2.3	0.3	0.13	0.2%
30-Jun-16	-	-	0.00	0.0%
30-Jun-17	2.8	0.3	0.12	0.2%

Comments

We believe there are several catalysts that could provide further positive impetus for the PCL share price over the next 6 months. These include the farm down of an interest in the L6 concession offshore Kenya and BG drilling an exploration well on the L10A/10B offshore Kenya in 1Q 2014.

Analyst Simon Andrew
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Last Updated: 06/09/2013

Sources: IRESS, Company Information, Hartleys Research

KEY ASSUMPTIONS / RISKS

Our valuation methodology is based on risked value of resource potential using notional in ground valuation and conservative estimates for probability of success. This methodology results in Net Asset Value of 84cps.

Our price target is a qualitative discount to our valuation based on market cap, liquidity and takeover premium. In PCL's case, this discount has been estimated at 70% resulting in a price target of 25cps.

PCL currently has A$34m in cash with quarterly corporate overheads estimated to be A$400k. In our view the anticipated work program over the next 12 months will involve capital expenditure of approximately A$19m.

Fig. 1: Asset Valuation

Permit (Interest)	Country	Operator	Net Recoverable Potential	NPV per Unit	POS	Risked Value ($m)	Risked Value (cps)	Unrisked Value (cps)
Exploration Assets								
L8 (15%)	Kenya	Apache	300 mmboe^	$0.75	20%	181.9	15.8	99.4
L6 (40%)	Kenya	FAR	2,030 mmboe^^	$0.5	6%	428.8	37.3	682.6
L10A (15%)	Kenya	BG	275 mmboe^^	$0.5	10%	93.8	8.1	81.5
L10B (15%)	Kenya	BG	275 mmboe^^	$0.5	10%	93.8	8.1	81.5
EL 0037 (30%)	Namibia	Tullow	563 mmbbls	$10.0	3%	140.7	12.2	489.0
Baniyas (20%)	Australia	Strike	5 mmbbls	$15.0	5%	3.6	0.3	6.3
Total			**3,448 boe**			**943**	**82**	**1440**

Source: PCL, Hartleys

^ Based on gas case for Mbawa and weighted potential for oil or gas on 50/50 basis

^^ BOE based on weighted potential for oil or gas on 50/50 basis

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a "Buy". Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a "Buy".
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative Buy	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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