Hartleys

PCL.asx
Speculative Buy

Conventional Oil & Gas: Explorer

PANCONTINENTAL OIL AND GAS NL (PCL)

Milio, Sunbird…..green shoots

With market sentiment towards oil explorers at rock bottom we thought it was worthwhile highlighting what news flow investors might expect over the next three months from Pancontinental Oil and Gas (PCL). Clearly the most important catalyst is the drilling of the Sunbird prospect. Drilling has commenced and initial target depth is expected to be hit around the **15th of March**. Other catalysts include a resolution to the L8 work program and a farm-down of the offshore portion of L6 following the recent announcement of a farm-out of the on-shore portion.

Drilling Sunbird 1 has commenced……

PCL and its JV partners commenced drilling of the Sunbird prospect on the 10th of January. With an estimated 60 days of drilling this would see the well reach the initial target depth on around the **15th of March**. PCL and its joint venture partners have not released an estimate of the prospective resource contained in the Sunbird-1 target however our rough calculation estimates gross un-risked oil in place of approximately 800mbbls. A rough risked estimate (800mbbl x US$10 x 15% PoS x 18.75% = US$225m) values PCL's share of Sunbird on a risked basis at 20c/share.

Of course measuring success, at least early on, after well completion can be difficult because information released from the operator can be scarce. What we do know is that wireline logging in addition to fluid and pressure testing is being undertaken. Numerous examples exist around the world, especially in South-East Asia, of significant Miocene reef discoveries containing both oil and gas. Should the Sunbird-1 drilling confirm a working hydrocarbon system it opens up the potential of similar targets within the L10A block but also a play fairway running north into the Block L6 and L8 (See Figure 2).

Successful farm-out of on-shore portion of L6

PCL and its JV partners in block L6 have successfully farmed down the onshore portion of the block to Milio International. In return for an agreed work program Milio will earn a 60% participating interest and operatorship of the onshore portion of L6. The work program will include a 1,000km 2D seismic program and drilling and testing of an exploration well (expected to spud in early 2015). Negotiations around the future work program and the participants in the L8 block are ongoing. The PSC expiry date has been extended to **February 20 2014** to allow the various participants to sort out the mess left by the withdrawal of Apache (now being denied) and Tullow.

December Quarterly highlights

At the end of the December quarter PCL had a cash balance A$34.4m. Cash outflow for the coming quarter is expected to be A$20m leaving an estimated cash balance of A$14.4m at the end of the March quarter. With a post-Sunbird EV of A$34m PCL is at a 12month low based on this metric. Offshore oil exploration is by nature risky and capital intensive with most wells having a low chance of success. On the flipside even moderate success can result in substantial share price appreciation.

5 Feb 2014

Share Price:	$0.042
12mth Price Target:	$0.23

Hartleys Brief Investment Conclusion
PCL holds a large acreage position offshore Kenya and Namibia. PCL is participating in up to three 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
Anthony Maslin	NED

Top Shareholders:

Sundowner International Limited	11.6%

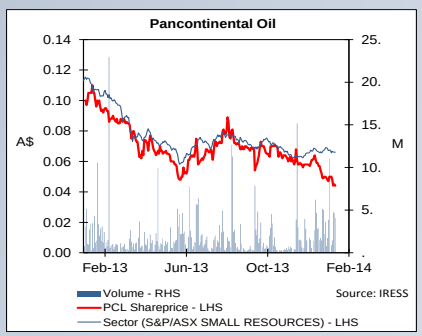
Company Address:
Ground Floor, 288 Stirling St
Perth, WA, 6000

Valuation:	$0.91
Issued Capital:	1151.0m
- fully diluted	1156.0m
Market Cap:	$48.3m
- fully diluted	$48.6m
Cash Equiv Dec '13):	$34.4m
Debt (Dec '13):	$0.0m

Valuation Summary

Asset	Value A$m	Risked cps	Unrisked cps
Exploration			
L8 (30%)	174.5	0.15	0.89
L6 (40%) Offshore	512.8	0.44	7.39
L10A (18.75%)	163.8	0.14	1.42
L10B (15%)	23.7	0.02	0.68
EL 0037 (30%)	177.8	0.15	1.54
Total	**1,052.6**	**0.91**	**11.92**

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. The Analyst is a director of a private company that owns 23,553,334 shares in PCL. Whilst the Analyst does not own any shares in this private company he does have a beneficial interest in unlisted company options

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SUMMARY MODEL

Pancontinental Oil and Gas PCL

Share Price $0.042

5 Feb 14

Speculative Buy

Key Market Information

Share Price	**$0.042**
Market Capitalisation	$48m
Net Debt (cash)	$34.4m
Issued Capital	1151.0m
ITM options	0.0m
Options	5.0m @ A$0.13
Issued Capital (fully diluted ITM options)	1156.0m
Issued Capital (fully diluted all options)	1156.0m
EV	$13.9m
Valuation	**$0.91**
12Mth Price Target	**$0.23**

Directors / Company Details

David Kennedy	Chairman
Barry Rushworth	CEO
Ernest Myers	Finance Director
Anthony Maslin	Non-Executive Director

Top Shareholders

	m shs	%
Sundowner International Limited	134.1	11.6%

Projects

Projects	Interest	Location	Commodity
L6 (offshore)	40%	Kenya	Oil/Gas
L8	30%	Kenya	Oil/Gas
L10A	18.75%	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.

Valuation Summary

Asset	Value A$m	Risked cps	Unrisked cps
Exploration			
L8 (30%)	174	0.15	0.89
L6 (40%)	513	0.44	7.39
L10A (18.75%)	164	0.14	1.42
L10B (15%)	24	0.02	0.68
EL 0037 (30%)	178	0.15	1.54
Total	1,053	0.91	11.92

Expected News flow

		Project
1Q 14	BG well in L10A	Kenya
1Q 14	Seismic program (Tullow)	Namibia
1Q 14	Farm-down of L6	Kenya
2Q 14	Announcement regarding L8	Kenya
3Q 14	2nd well in L10A or 10B	Kenya

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 most signficant of these will be BG drilling an exploration well in L10A offshore Kenya. Other catalysts include the farm down of the offshore interest in the L6 concession expected in early 2014.

Analyst Simon Andrew
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Last Updated: 05/02/2014

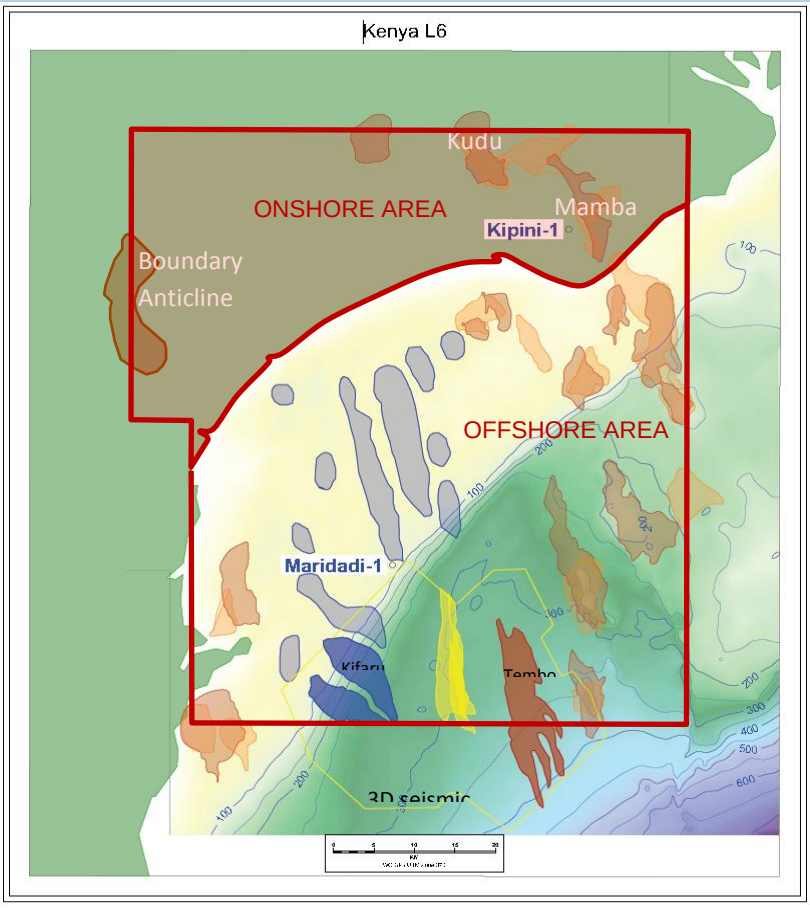
Sources: IRESS, Company Information, Hartleys Research

FARM-DOWN OF L6 (ONSHORE)

Pancontinental Oil & Gas (PCL) and its JV partners in block L6 have successfully farmed down the onshore portion of the block to Milio International. In return for an agreed work program Milio will earn a 60% participating interest and operatorship of the onshore portion of L6. The work program will include a 1,000km 2D seismic program and drilling and testing of an exploration well (expected to spud in early 2015).

After completion of the deal, which is subject to final approval from the Kenyan Government, PCL will hold a 16% interest in the onshore section of the block and retain a 40% interest in the offshore part of the block. Milio holds an interest in Block L20 which sits directly to the west of L6. We understand this is the first time the Kenyan government has allowed part of a block to be quarantined.

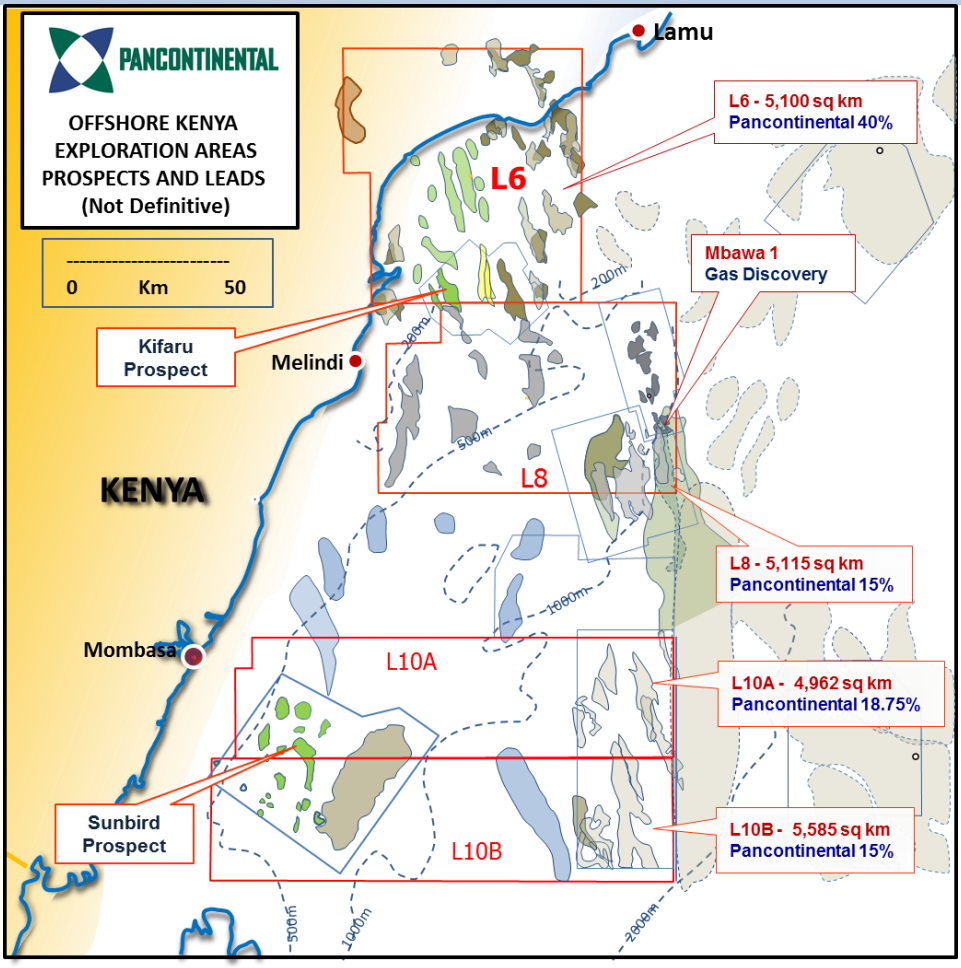
Fig. 1: Block L6 – On-shore and off-shore portions



Source: Company Presentation

To be free carried on an onshore exploration program whilst retaining a large equity interest in the offshore block (where PCL's expertise exists) is a good result. By maintain a large equity position in the off-shore portion of the block, PCL and its JV partners can explore further farm-out opportunities.

Fig. 2: PCL – Off-shore Kenya prospects and leads



Source: Company Presentation

RISKS

The key risks for PCL (like most oil & gas exploration companies) is making an economic discovery and obtaining the funding for ongoing exploration. Other risks include delays, key person risk, country/sovereign risk, weather, JV partner obligations, cost inflation. Investing in explorers is very risky given the exploration value of the company in essence assumes that the market will recognise a portion of potential value before the results of an exploration program are known, conscious that the ultimate chance of success is low (typically 1%-20%) and that failure is much more likely, in most cases. Other risks are earnings disappointments given the industry is volatile and earnings can disappoint due to cost overruns, project delays, cost inflation, environmental regulations, resource estimate errors and management performance and contract negotiation skills. High financial leverage (if it exists at that time) would add to the problem.

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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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