# Providence Resources PLC

**Initiation of coverage** | **Oil & Gas** | **29 January 2013**

## Waiting for a thumbs up to Barryroe

**Price: 629p**

**BUY**

**Unconnected research**

**We initiate coverage of Providence Resources with a BUY recommendation. Farm-out of the Barryroe discovery and the 2013 exploration program could provide significant upside potential in the event of a success. Providence offers, in our view, a favourable risk - reward proposition at the current price.**

**The farm-out of the Barryroe oil discovery is central to Providence's investment proposition:** The Barryroe oil discovery, which is located offshore Ireland, is currently in the appraisal stage. Providence Resources will try to bring in a partner to develop the field. We believe that the Barryroe discovery is likely to be a commercially viable field. In our valuation model, we have assumed a 75% probability of success for Providence to farm-out its Barryroe discovery on a \$4.2/boe valuation.

**2013 drilling programme:** Resource upgrades can continue to come through for Providence Resources through its 2013 drilling programme, which is targeting 400 - 450mmboe net unrisked prospective resources with three wells (incl. an appraisal well - Spanish Point). With a blue sky upside of +927p/sh, the upcoming drilling programme has the potential to re-rate the shares, in our view.

**Free option on potential M&A upside:** We believe that Offshore Ireland is emerging as an exploration hotspot for oil and gas companies. With the largest holding of licences offshore Ireland, including a stake in the Barryroe oil discovery, Providence Resources could also be an attractive M&A target to a new entrant to the offshore Ireland hydrocarbon basins.

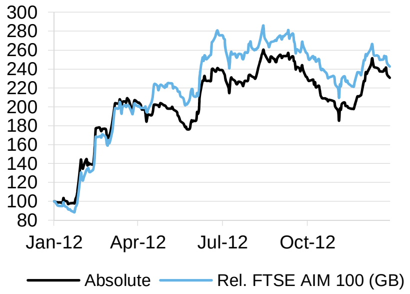
**Funding:** Providence Resources is fully funded for the 2013 exploration drilling programme.

**Risk factors:** 1) An unfavourable farm-out could have a significant negative impact on the stock; our base case assumption is a 50% farm-in discount. 2) The expected capital spend on the 2013 drilling programme is \$43m to \$46m (~44p/sh). It includes high risk exploration activities which could result in disappointing exploration results.

**Valuation:** Our estimate of the NPV/bbl value of Barryroe is \$8.4/boe. But a farminee would try to acquire a stake for less; we have assumed a 50% farm-in discount. We have assumed a 75% probability of a farm-out deal happening on a \$4.2/boe valuation.

Our risked NAV for Providence Resources stands at 919p/sh with 260p/sh of risked exploration upside based on a \$95/bbl long term oil price assumption. Providence Resources trades at a 30% discount to our risked NAV.

### Share price performance (indexed)




### Key data

| | |
|---|---|
| Stock code | PVR LN |
| Market cap (£m) | 405 |
| FTSE AIM 100 (GB) | 3305 |
| 1mth perf (%) | 4.3 |
| 3mths perf (%) | (9.0) |
| 12mths perf (%) | 124.5 |
| 12mth high-low (p) | 756 - 270 |
| Free float (%) | 84 |

*All data as at close on 28 January 2013*

*All \$ are US dollars unless otherwise stated*

*All sources unless otherwise stated: Company data, Factset, Oriel Securities*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# Key data[1]

**NAV Valuation**

| 01 Jan 2013 | WI Res (mmboe) | NAV (US$) | NAV (p/share) |
|---|---|---|---|
| Cash balance | | 50 | 49 |
| Barryroe (MW & BW) | 224 | 701 | 681 |
| Barryroe (Purbeckian & Lower Wealden) | 62 | 195 | 190 |
| Risked NAV | 286 | 947 | 919 |

**Exploration Upside**

| 01-Jan-13 | Net (%) | Net Res (mmboe) | Unrisked EMV (p/sh) | Risked EMV (p/share) |
|---|---|---|---|---|
| Dunquin | 16 | 272 | 551.1 | 93.7 |
| Dalkey Isalnd | 50 | 125 | 506.5 | 101.3 |
| Spanish point | 32 | 32 | 129.7 | 64.8 |
| EMV | na | 429 | 1187.2 | 259.8 |

**Key operational data**

| | 2012A | 2013E | 2014E | 2015E |
|---|---|---|---|---|
| Brent oil price (US$/bbl) | 108.4 | 100.0 | 95.0 | 95.0 |
| US$/£ FX rate | 1.6 | 1.6 | 1.6 | 1.6 |

# Key information

**Business description**

Providence Resources is an independent E&P company focused on oil and gas exploration and appraisal activities offshore Ireland. The company plans to participate in a multi-year drilling program in six different basins in offshore Ireland. As a pure play exploration company, it is at the early stages of the E&P cycle; it does not have a production base, hence does not generate any cash at this stage.

Providence Resources is registered in Ireland and has a listing on the UK Alternative Investment Market (AIM) and Irish Stock Exchange; ticker PVR.

**Senior management**

Dr. Brian Hillery (Chairman)
Tony O'Reilly (CEO)
John O'Sullivan (Technical Director)

**Key dates**

Updated CPR by end 1Q '13
Dunquin drilling result in 2Q '13
Probable farm-out announcement in mid-2013

**Major shareholders**

Sir Anthony O'Reilly - 15.4%
JP Morgan AM - 5.9%
Henderson Global Investment Ltd - 3.9%

**Website**

www.providenceresources.com

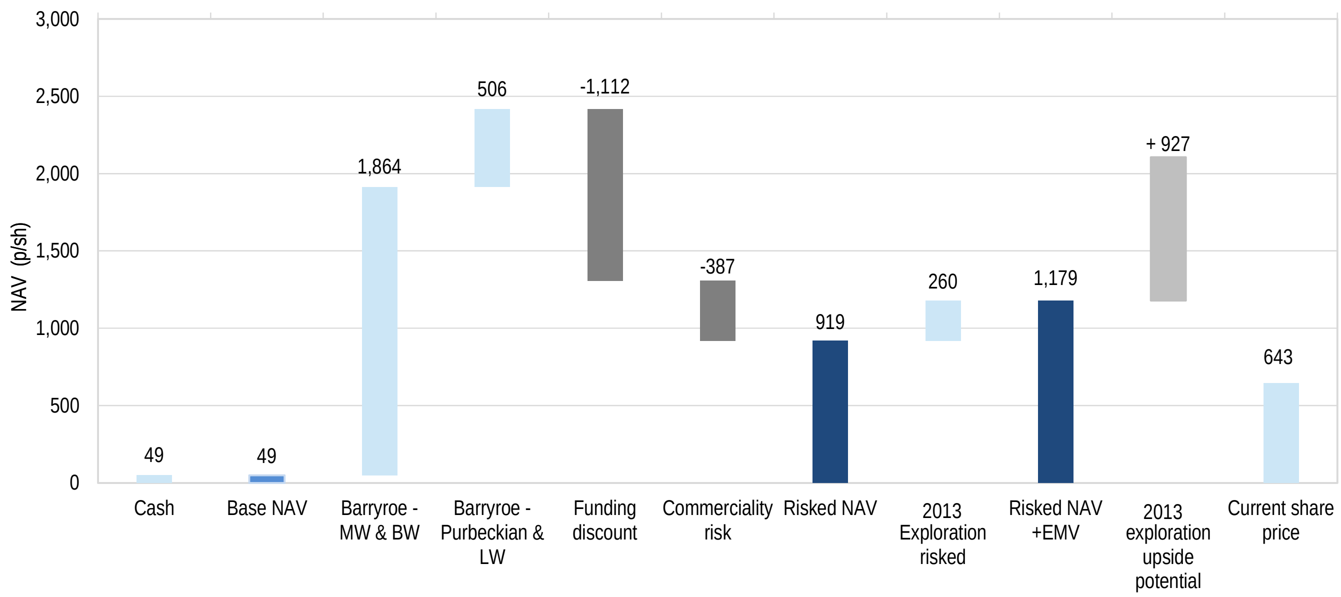
*[1]Year end December*
*Source: Company data, FactSet, Oriel Securities estimates*

# Investment case

We initiate coverage of Providence Resources with a BUY rating. Providence Resources is an independent E&P company focused on oil and gas exploration and appraisal activities offshore Ireland. Most of Providence Resource's valuation is based on the Barryroe oil discovery in the North Celtic Sea basin in Ireland. The Barryroe oil discovery is currently in the appraisal stage and Providence Resources is seeking a partner through a farm-out process to develop the field.

In Providence Resource's investment case, two main factors - the Barryroe farmout and the 2013 exploration program - stand out as not just likely to provide significant upside potential in the event of a success (+1314p/sh blue sky potential upside), but also liable to have a negative impact on the share price if unsuccessful. Overall, we believe that Providence Resources offers a favourable risk-reward proposition at the current share price. Our risked NAV (919p) includes huge discounts (c.a. 63% cumulatively) to reflect the possible farm-in dilution and risks. The stock is trading at a 30% discount to our risked NAV.

**Figure 1: Providence Resources valuation - sum of the parts**




*Source: Oriel Securities estimates*

## Barryroe farm-out is central to Providence's investment proposition

We believe that the 2012 appraisal program, which included an appraisal well and two production flow tests, has partially derisked the Barryroe discovery. Since Providence currently does not have enough funds to commit to the field development of Barryroe itself, it will try to bring in an industry partner through a farm-out. Bringing in an industry partner to the Barryroe development would provide 1) validation of the commerciality of the Barryroe hub 2) funding for the multi-billion dollar field development and 3) an operator for this field.

A failure to bring in an industry partner to the Barryroe development would have a negative impact on the stock because developing the Barryroe field by itself would be a big challenge for Providence's financial and operational ability.

We believe that the Barryroe discovery is likely to be a commercially viable field. In our valuation model, we have assumed a 75% probability of success for Providence to farm-out its Barryroe development on a $4.2/boe valuation (50% farm-in discount).

## Catalyst rich 2013 drilling program offers material upside

Providence's 2013 drilling programme is targeting 400mmboe to 450mmboe net unrisked prospective resources with three wells. We are carrying the 2013 exploration drilling programme in our valuation model with an EMV of 260p/sh; with a blue sky upside of +927p/sh, the upcoming drilling programme has the potential to re-rate the shares, in our view.

**Figure 2: 2013 drilling outlook**

| Prospect | Likely spud | Equity (%) | Gross volumes (mmboe) | Net volumes (mmboe) | Unrisked EMV p/sh | Risked EMV p/sh | Blue sky upside p/sh |
|---|---|---|---|---|---|---|---|
| Dunquin | 1Q '13 | 16 | 1,700 | 272 | 551 | 94 | 457 |
| Dalkey Island | 2H '13 | 50 | 250 | 125 | 506 | 101 | 405 |
| Spanish point | 2Q/3Q '13 | 32 | 100 | 32 | 130 | 65 | 65 |

*Source: Oriel Securities estimates*

## Stock trading at 30% discount to risked NAV of 919p/share

Our risked NAV for Providence Resources stands at 919p/sh with 260p/sh of risked exploration upside based on a $95/bbl long term oil price assumption. Barryroe is the biggest component of the valuation - around 78% of our risked NAV + EMV. Our estimate of the NPV/bbl value of Barryroe is $8.4/boe. We have assumed an operating efficiency of 70% during plateau production period to reflect possible operational challenges such as a longer production ramp up after start-up due to the waxy nature of the Barryroe crude.

We are carrying 280mmboe recoverable resources for Barryroe based on an assumption of 31% recovery factor for the Middle Wealden & Basal Wealden sands and 10% recovery factor for the Purbeckian and Lower Wealden sands (refer Figure 8 for details on Barryroe resource volumes).

**Figure 3: Risked NAV summary**

| Fields | CoS (%) | Net resources (mmboe) | NPV (US$/boe) | NAV ($m) | NAV p/share |
|---|---|---|---|---|---|
| Cash balance | | | - | 50 | 49 |
| **Base NAV** | | | | **50** | **49** |
| Barryroe (MW & BW) | 75 | 224 | 4.2 | 701 | 681 |
| Barryroe (Purbeckian & Lower Wealden) | 75 | 62.4 | 4.2 | 195 | 190 |
| **Appraisal NAV** | | | | **897** | **870** |
| **Total risked NAV** | | | | **947** | **919** |

*Source: Oriel Securities estimates*

**Figure 4: EMV summary**

| Field/prospect | Net resources (mmboe) | CoS (%) | Value ($/bbl) | Unrisked EMV ($m) | Risked EMV ($m) | Unrisked EMV p/share | Risked EMV p/share |
|---|---|---|---|---|---|---|---|
| Dunquin | 272 | 17 | 2.1 | 568 | 97 | 551 | 94 |
| Dalkey Island | 125 | 20 | 4.2 | 522 | 104 | 506 | 101 |
| Spanish point | 32 | 50 | 4.2 | 134 | 67 | 130 | 65 |
| **Total EMV** | **429** | | | **1,223** | **268** | **1,187** | **260** |

*Source: Oriel Securities estimates*

## Discounts applied (c.a. 63% cumulatively) to our risked NAV for Barryroe to reflect the possible dilution and risks

Any company coming in would look to acquire the stake at a discount to the fair value, in our view. We have applied a 50% dilution or funding discount to capture this.

We have estimated a 75% probability of a successful Barryroe farm-out; this reflects the operational challenges and development funding commitment involved. It also captures the commerciality risk of a field at this stage in the E&P cycle.

## Free option on potential M&A upside

We believe that Offshore Ireland is emerging as an exploration hotspot for oil and gas companies due to an attractive combination of factors - proven hydrocarbon systems, benign operating environment, relatively low government take, underexplored basins and geo-political stability.

With the largest holding of licences offshore Ireland, including a stake in the Barryroe oil discovery, Providence Resources could also be an attractive M&A target to a new entrant to the offshore Ireland basin. Providence’s portfolio is an attractive package of assets for a company keen to enter the Irish basin - the discoveries could give a kick-start to the entrant and the exploration licences could provide the opportunity for further growth.

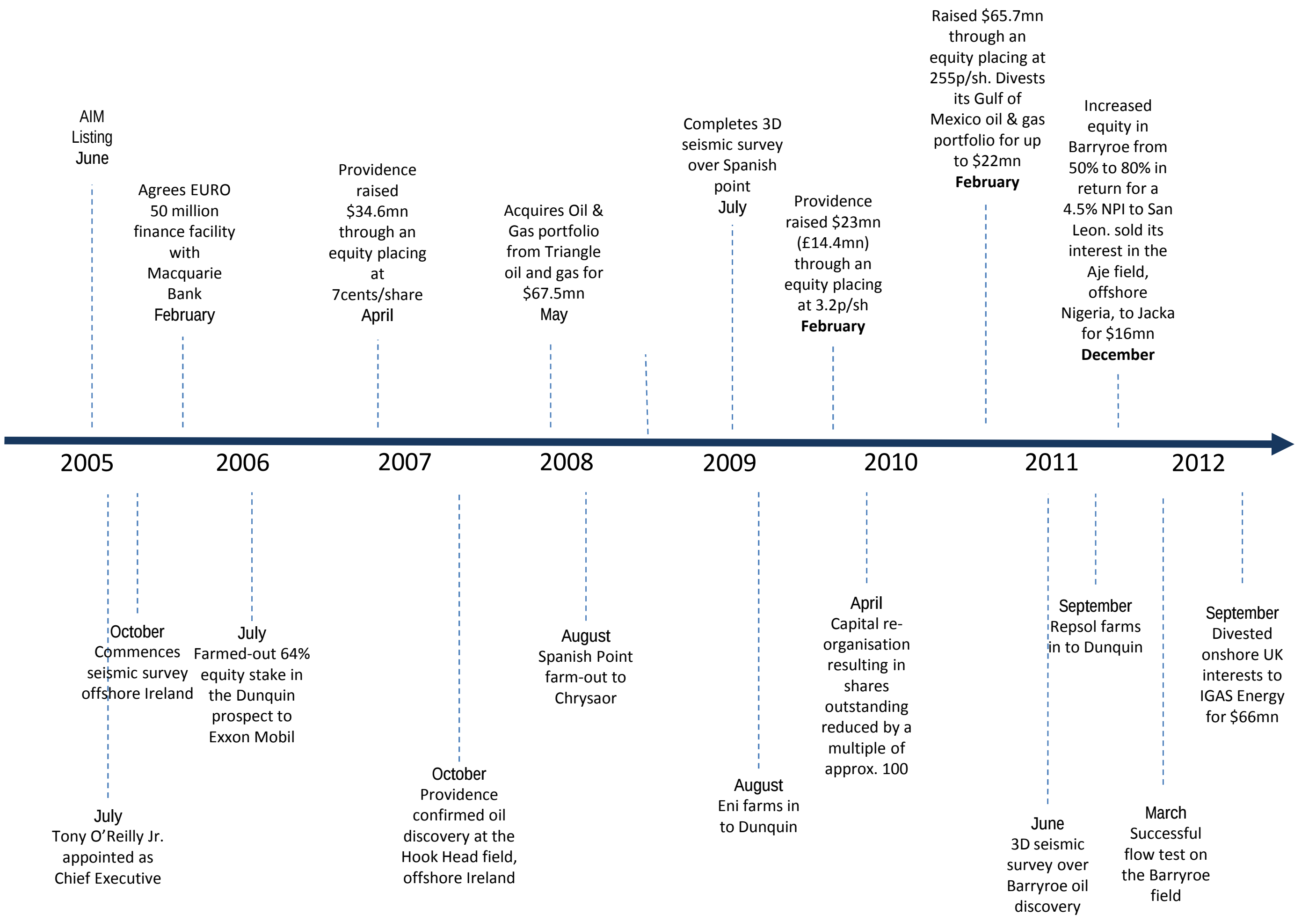
# Company profile

Providence Resources is an independent E&P company focused on oil and gas exploration and appraisal activities offshore Ireland. The company plans to participate in a multi-year drilling program in six different basins offshore Ireland. As a pure play exploration company, it is at the early stages of the E&P cycle; it does not have a production base, hence does not generate any cash at this stage. Providence's strategy is to monetise its assets through farm-outs or asset deals before incurring huge field development costs.

Providence Resources is registered in Ireland and has a listing on the UK Alternative Investment Market (AIM) and Irish Stock Exchange; ticker PVR. In 2004, following a strategic review, Providence Resources was recapitalised and appointed new management. Tony O'Reilly joined as CEO in 2005.

Providence is the first company to prove up the potential of an oil development offshore Ireland with the drilling and flow testing of an oil well on the Barryroe field in March 2012. Providence will now try to bring in an industry partner to develop the field. Providence Resources has a market cap of around $700m. Around 84% of its outstanding shares are in free float; the O'Reilly family owns 16% of the company. Average daily traded value over the last 6 months was $3m.

**Figure 5: Providence timeline**




*Source: Providence Resources*

# Barryroe

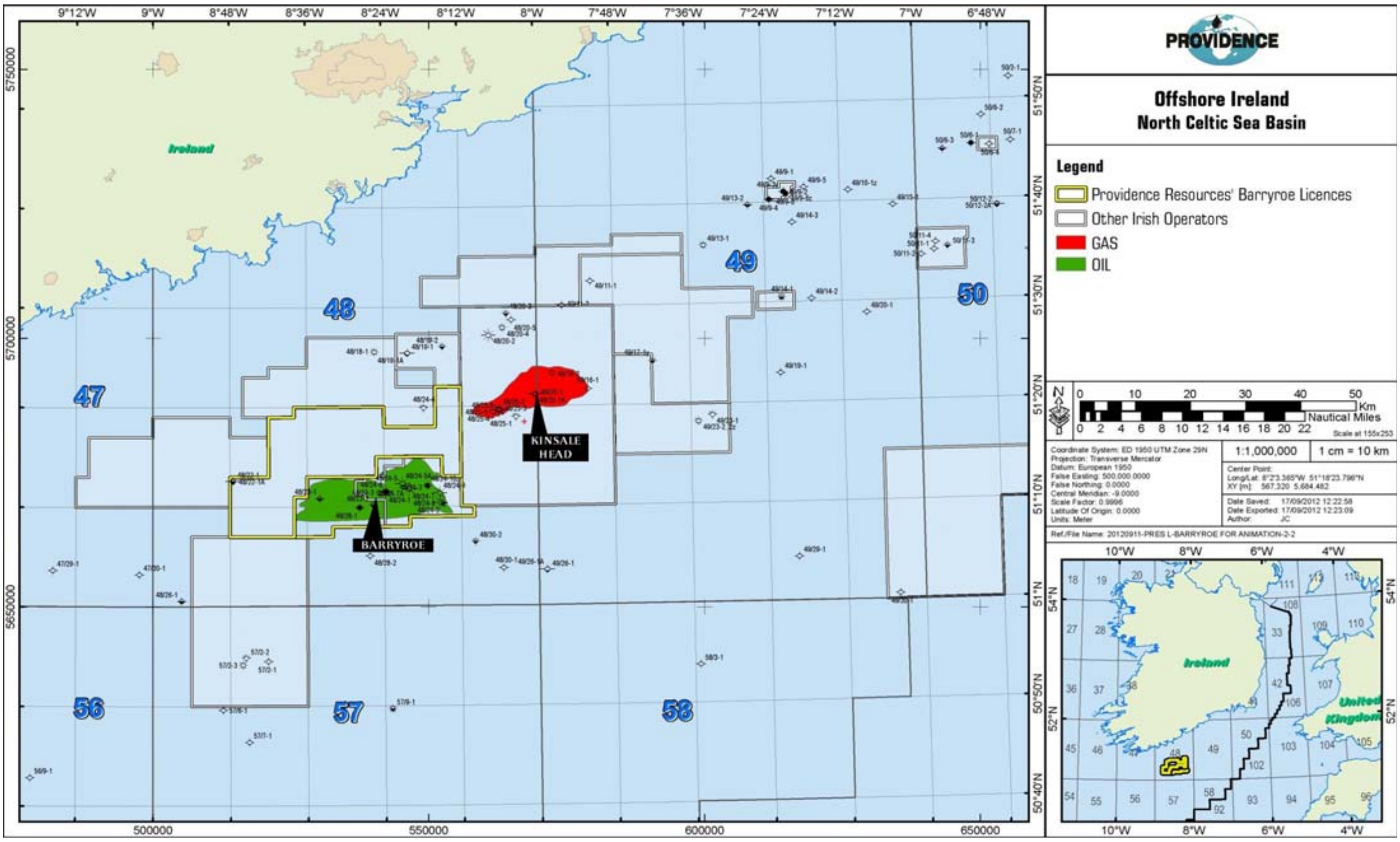
## Celtic Sea Basin

The Celtic Sea basin is one of a system of Mesozoic rift basins south of Ireland. Three plays can be recognised distinctly in this basin: a) an oil play with a Jurassic reservoir, b) a Middle to Lower Wealden oil play in the Cretaceous c) and a Cretaceous gas play.

## Barryroe

The Barryroe field is located in the Standard Exploration Licence 1/11 which covers an area of 316sq. km in the North Celtic Sea Basin. The Barryroe Licence is held by Providence Resources (80% equity, operator) and Lansdowne (20% equity). Part of the Barryroe acreage lies beneath the compartmentalised Seven Heads Gas Field, with the boundary between the two concessions lying at approx. 1,250m sub-sea. This field is in 100m water depth and 50 km offshore South East Ireland. The Barryroe oil field was discovered by Exxon in 1974. Prior to the 2011 - 2012 appraisal well, 5 wells had been drilled on Barryroe; all of these wells had encountered hydrocarbons, but the field was not developed then due to i) a lack of infrastructure to produce waxy crude from a possibly compartmentalised reservoir ii) lower prices resulting in weak project economics, iii) an unattractive fiscal regime and most importantly iv) a lack of technology such as 3D seismic.

**Figure 6: Location of the Barryroe field**




*Source: Providence Resources*

Providence Resources acquired San Leon's 30% stake in the Barryroe field in return for a 4.5% net profit interest in the field before the 2011-12 appraisal program on this field.

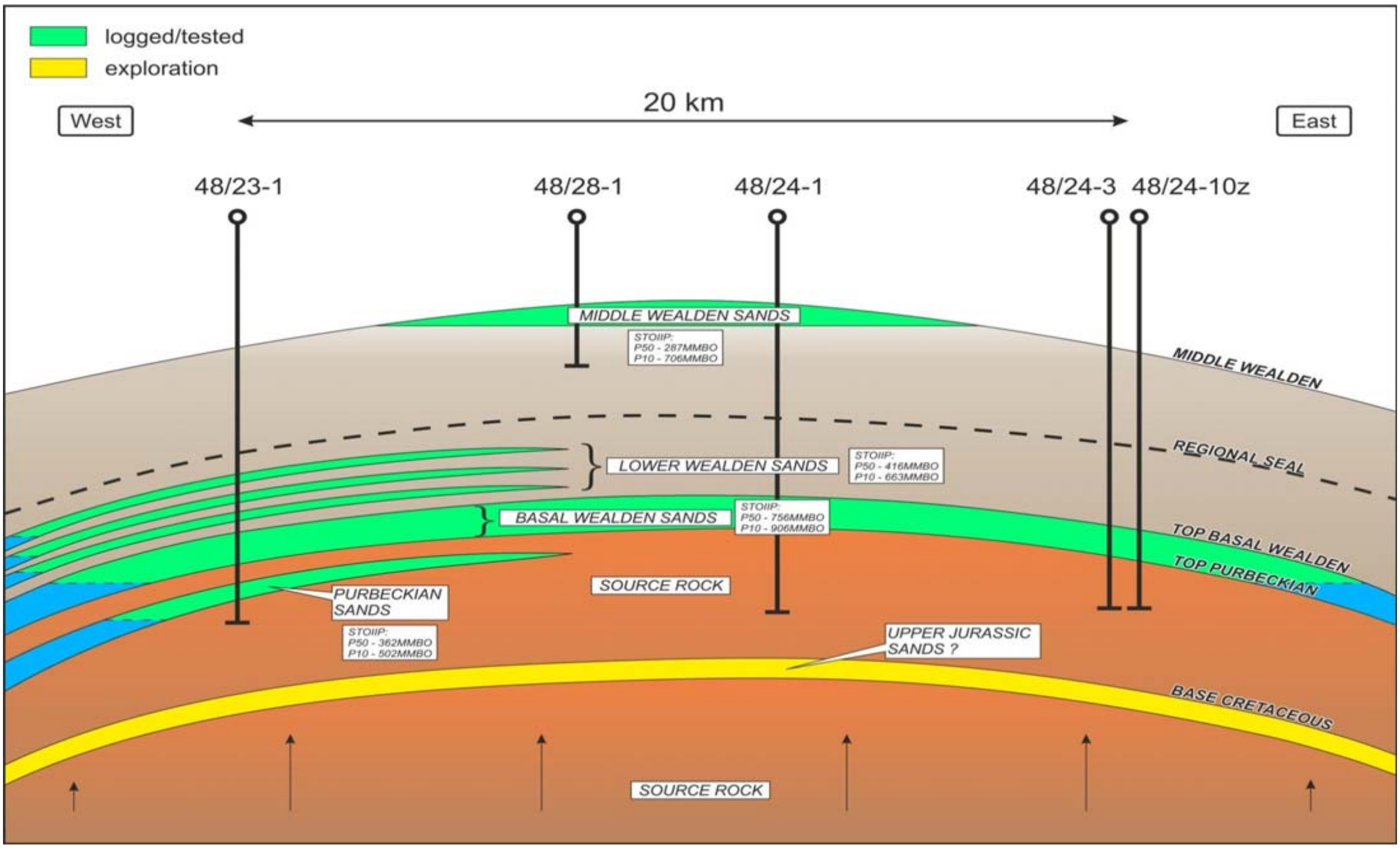
The Barryroe appraisal well 48/24-10z commenced in November 2011 and was completed in March 2012 after testing oil and gas from a Basal Wealden sandstone reservoir sequence in the field. The flow test over a 24ft thick net pay oil bearing basal interval flowed at a stabilised rate of 3,514boed and 2.93mmscfd (4,000boed).

The oil was found to be light (42 degree API), waxy (wax content ca. 20%, pour point 27 deg Celsius), with a Gas Oil Ratio of 800scf/bbl and was of low viscosity at reservoir conditions (0.68 centipoises).

This well also helped Providence re-calibrate its model by integrating the drilling results of this well with the 3D seismic, which was acquired in 2011, and with the five other wells drilled on Barryroe by Exxon. This well could not penetrate the Purbeckian sands due to drilling delays.

## Barryroe - resource estimates

**Figure 7: Barryroe field – schematic cross section**




*Source: Providence Resources*

The latest estimate of the resource volumes for the Barryroe field is shown below:

**Figure 8: Barryroe resource volumes**

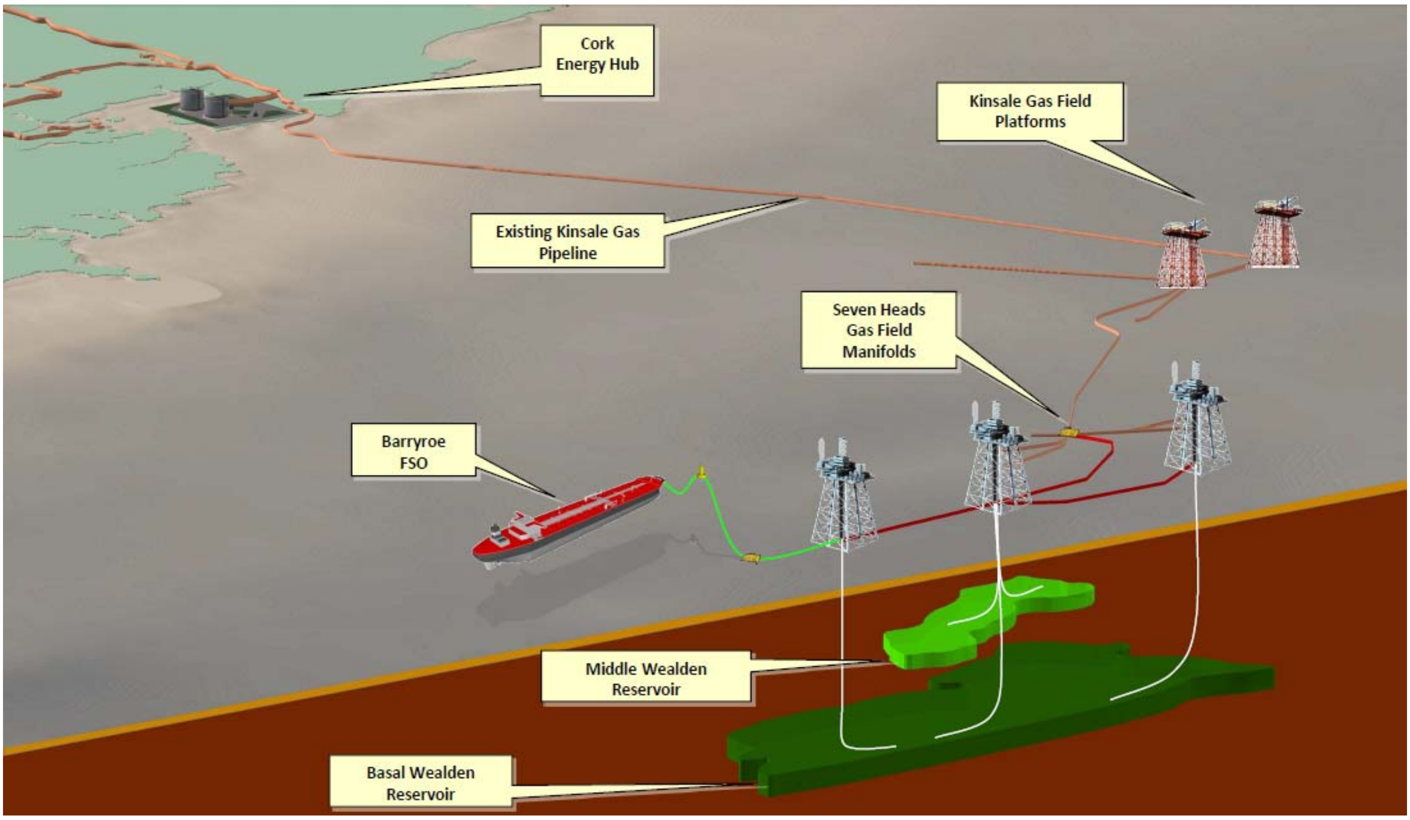
| | | Company guidance | | Oriel estimates | |
|---|---|---|---|---|---|
| **Reservoir sands** | **P50 OIP volumes (mmboe)** | **Recovery factor (%)** | **Resource estimate** | **Recovery factor (%)** | **Resource estimate** |
| Middle Wealden | 287 | 16 | 46 | 16 | 46 |
| Basal Wealden | 756 | 31 | 234 | 31 | 234 |
| | 1,043 | 27 | 280 | 27 | 280 |
| | | | | | |
| Purbeckian | 362 | - | - | 10 | 36 |
| Lower Wealden | 416 | - | - | 10 | 42 |
| | 778 | - | - | 10 | 78 |

*Source: Providence Resources, Oriel Securities estimates*

The company estimates the P10 STOIIP resource volumes at 2,777mmboe. The Upper Jurassic sands, a deeper target below the main reservoir, haven't been tested and offer additional exploration upside according to Providence Resources. The company expects to provide an update on the prospective resource potential of the upper Jurassic sands in 1Q 2014, following mapping of the reprocessed 3D data.

In our valuation model, we are carrying 280mmboe recoverable resources for Barryroe based on an assumption of 31% recovery factor for the Middle Wealden & Basal Wealden sands and 10% recovery factor for the Purbeckian and Lower Wealden sands.

**Figure 9: Schematic illustration of the Barryroe field development**




*Source: Providence Resources*

Two main risks associated with the Barryroe oil discovery are reservoir continuity and the high pour point (27 deg Celsius) of the oil. The Seven Heads field, in the overlying Upper Wealden reservoir, is heavily compartmentalised; hence we believe that there is a risk that Barryroe could also be compartmentalised. A successful extended well test (EWT) could mitigate these concerns by testing the dynamic reservoir behaviour; an EWT on Barryroe isn't planned before the farm-out discussions. Providence believes that 3D has mitigated the risk of compartmentalisation. According to Providence, the Barryroe reservoirs are probably not compartmentalised because the seismic inversion study has shown that the Basal sands (Barryroe reservoir) are continuous unlike the Upper Wealden sands (Seven Heads field). Providence also believes that the fault density is lower in the Basal sands compared to the Upper Wealden sands. Company guidance is that potential compartmentalisation challenges, if any, on the Barryroe field can be overcome by drilling horizontal development wells.

In our valuation model, we have assumed an operating efficiency of 70% during plateau production period to reflect possible operational challenges such as a longer production ramp up after start-up and greater unplanned losses due to the waxy nature of the Barryroe crude and potential compartmentalisation of the reservoir.

## Upcoming catalysts

### New competent persons report to be completed by end of 1Q '13

An updated CPR is expected to be issued by the end of 1Q 2013. The latest company guidance on the Barryroe resource volumes has a mid-case STOIIP volume estimate of 1871mmboe. The updated CPR would take into account the data from the recent appraisal activities and the 3D seismic volume analysis.

### Probable farm-out announcement in mid-2013

We believe that a farm-out agreement with an industry partner could be a major catalyst on this stock in 2013. We think that developing the Barryroe field could be a big challenge for Providence's financial and operational capability. Providence's public stance is to bring in an industry partner through a farm-out process to advance the Barryroe development. Bringing in an industry partner in its Barryroe development could provide 1) validation of the commerciality of the Barryroe discovery, 2) funding for the multi-billion dollar Barryroe field development, and 3) an operator for this field.

In our model, we have assumed that Providence Resources could secure around $100m and a full carry till first oil in return for 40% to 45% equity (out of 80% equity) in its licence.

The Barryroe farm-out process could take between 3 to 9 months in our opinion (developing the marketing flyer, compiling the dataroom, executing confidentiality agreements with interested parties, supporting the due-diligence analysis of the participants, commercial negotiations and finally executing the sale & purchase agreement). With the farm-out process expected to start in 1Q 2013, a result could be announced in 2H 2013. We estimate that Providence Resources has sufficient funds to meet its exploration costs and overheads, even if the farm-out due diligence or negotiation is drawn out.

### 2013 exploration drilling programme offers material upside

With a blue sky upside of +927p/sh, the upcoming drilling programme has the potential to re-rate the shares, in our view. The wait for drilling catalysts is unlikely to be lengthy since Providence Resources has a busy 2013-2014 drilling programme.

**Figure 10: 2013 drilling outlook**

| Prospect | Likely spud | Equity (%) | Gross volumes (mmboe) | Net volumes (mmboe) | Unrisked EMV p/sh | Risked EMV p/sh | Blue sky upside p/sh |
|---|---|---|---|---|---|---|---|
| Dunquin | 1Q '13 | 16 | 1700 | 272 | 551 | 94 | 457 |
| Dalkey Island | 2H '13 | 50 | 250 | 125 | 506 | 101 | 405 |
| Spanish point | 2Q/3Q '13 | 32 | 100 | 32 | 130 | 65 | 65 |

*Source: Oriel Securities estimates*

The 2013 drilling programme is targeting 400mmboe to 450mmboe net unrisked prospective resources with three wells. We are carrying this drilling programme in our valuation model with an EMV of 260p/sh. The 2013 drilling programme is fully funded; it is not dependent on the result of the Barryroe farm-out.

**Figure 11: 2013 exploration and appraisal targets**

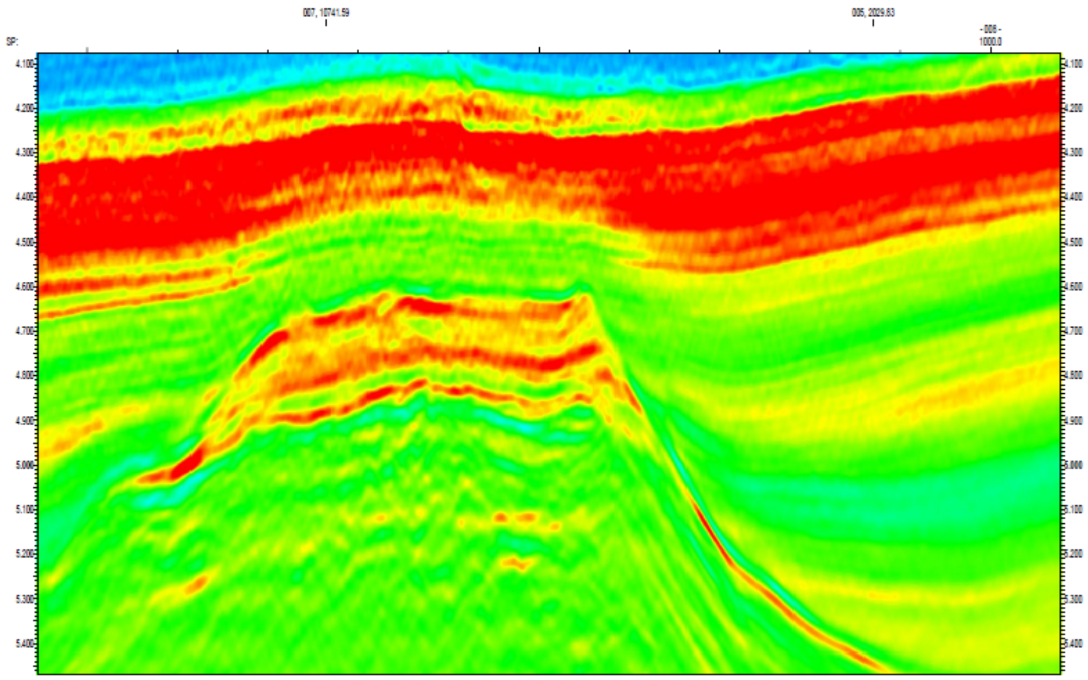
| | Dunquin prospect | Dalkey Island prospect | Spanish Point |
|---|---|---|---|
| Basin | South Porcupine Basin | Kish Bank Basin | Main Porcupine Basin |
| Distance | 200km offshore | 6km offshore | 170km offshore |
| Water depth | 1,500m | 25m | 350m |
| Reservoir depth | 5,000m | 1,700m | 4,200m |
| Reservoir age | Middle Cretaceous | Lower Triassic | Upper Jurassic |
| Reservoir type | Isolated carbonate platform | Fluvial/Alluvial | Deepwater turbidite sandstone |
| Trap type | Structural/stratigraphic | Structural | Tilted faulted block |
| Fluid type | Gas condensate/Oil | Oil | Gas condensate |
| Nearest discovery | Kenmare, 100km north, Middle/Upper Jurassic | Lennox field, Liverpool Bay | Connemara (26/28), 30km north, Middle Jurassic |
| Gross resource estimate | 8400bcf + 316mmbbl | 250mmboe | 100mmboe |
| Chance of success (Oriel estimate) | 17% | 20% | 50% |

*Source: Providence Resources, Oriel Securities estimates*

## Dunquin

Dunquin is a high risk/ high impact frontier exploration well, which is expected to spud in late 1Q '13. Exxon (operator) farmed in to Dunquin in 2006, followed by Eni (farmed in for 40% stake in 2009) and Repsol (farmed in for 25% stake in 2011).

**Figure 12: Dunquin prospect**



*Source: Providence Resources*

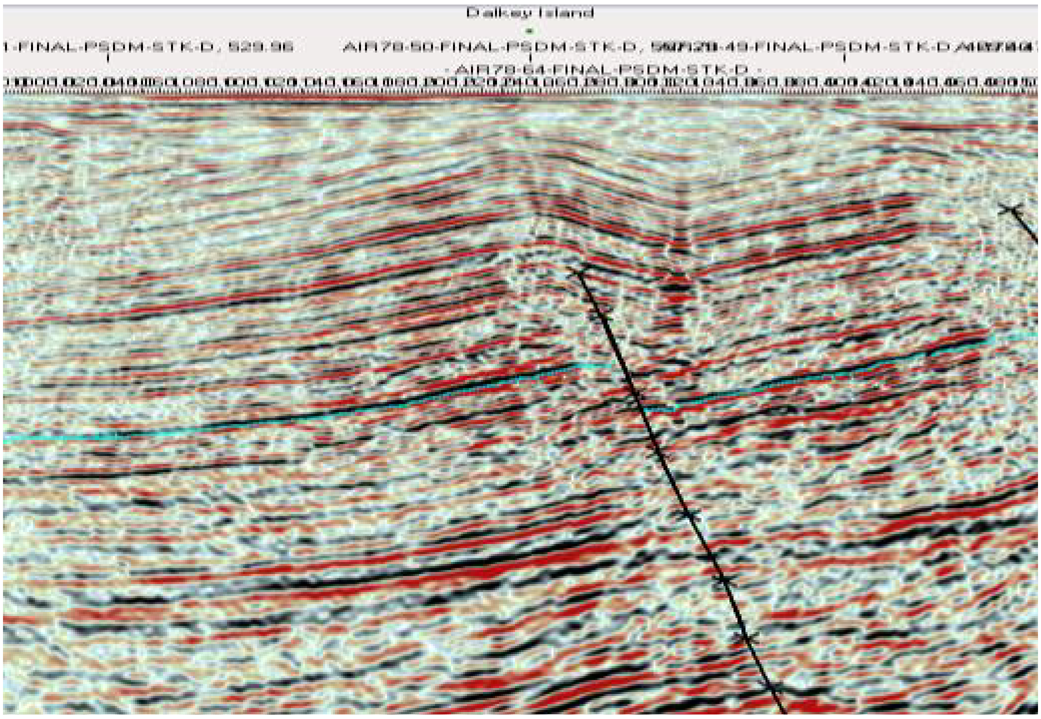
Dunquin is a late Jurassic to early Cretaceous carbonate deposit on a mid-Porcupine ridge system. It is a huge structure (around 700 square kilometres), hence offers significant upside (+457p/sh on our estimates) in the event of a successful drilling result. The P50 resource estimate for this prospect is 1.7bnboe; 8.4tcf of gas and 316mmboe of oil. The operator Exxon ascribes a 1-in-6 chance of success for this prospect. The key risks are reservoir presence and reservoir deliverability. With the water depth around 1,500m, this is deep water territory. Hence, any future development will require sufficient volumes to be commercial.

## Dalkey Island

The Dalkey Island prospect is located in the Standard Exploration Licence 2/11. It is a Triassic Sherwood sandstone target; this is the main reservoir from which several fields produce in the Liverpool Bay. This structure was formed before the oil and gas was generated in this region, unlike the other targets in this basin that were unsuccessful.

The drilling location of the Dalkey Island prospect is within the 12 nautical mile limit offshore Dublin, hence environmental and social issues needed to be addressed. The drilling of this well is expected to commence in 2H 2013. The drilling permit is in place, including the requisite foreshore licence, and the drilling location has been agreed. The rig has been contracted yet; the company guidance is that it is in advanced discussions with East Irish Sea operators on bringing a jack up rig over for one slot in 2H ’13.

**Figure 13: Dalkey Island**




*Source: Providence Resources*

## Spanish point

The Spanish Point field was discovered in 1981 by Philips Petroleum and relinquished. The well (35/8-2) encountered upper Jurassic sandstones at a high pressure. It penetrated around 400m of hydrocarbon bearing stacked turbidite fans with four reservoir intervals - A, B, C and D. The A sands flowed oil at 925bpd and 5mcfd gas; the B, C and D sands did not flow in the test due to tight reservoir.

Providence acquired the licence in 2004 and Chrysoar farmed in to the block in 2008. An appraisal well is planned to be spudded in 2Q ’13 / 3Q ’13. This well will primarily test whether commercial flow rates can be achieved from this structure; it will test the B and C sands. A secondary objective of this well is to test whether the Z sands in this structure contain hydrocarbons. The Z sands lie above the A, B, C and D sands, but were not present in the 35/8-2 well due to faulting.

The company’s estimate of the resource volumes for Spanish Point is 100mmboe (2C) with an upside to 200mmboe (3C). We are carrying 100mmboe (2C) in our valuation model with a 1-in-2 chance of success; we estimate the potential upside in the event of an exploration success at 65p/sh. Company guidance is that the chance of success on this well is higher than our 50% CoS assumption due to the 3D seismic over the field. The objective of this well is to test well productivity to define the capital expenditure profile for field development.

## Other prospects

Providence Resources also has other prospects in its portfolio that are part of its ongoing drilling program. Providence is seeking a farm-in partner with a view to drilling these targets in 2014. Currently, we are not carrying these resource volumes in our valuation model due to uncertainty around the outcome of the farm-out, the timing of the wells and Providence's final equity stake (post farm-out) in these prospects.

### Dragon gas discovery

The Dragon gas discovery, which straddles the UK and Irish jurisdictions in the St. Georges Channel basin, was drilled in 1994 by Marathon and this was followed up by an unsuccessful appraisal well on a separate fault block in 2005. The discovery well encountered gas in the Jurassic sandstones. The sands were sealed against the footwall of a normal fault. The appraisal well, which was drilled across the fault, encountered water in similar sandstones. Marathon concluded that the Dragon gas field probably contained around 55bcf of gas.

Providence acquired the licence on the Irish side of this play and generated an inverted seismic model of the reservoir using IKON Geoscience technology. This study demonstrated that the gas bearing zones of the reservoir could be distinctly identified. A gas in place estimate of 300bcf has been worked up for this reservoir, which has to be tested with a well. Providence is planning to get a farm-in partner to drill this well, which could cost around $22m (gross), in 2014.

### Rathlin Basin

The Rathlin Basin is frontier exploration territory. Providence has 100% equity stake (operator) in an onshore licence over Rathlin Island and six offshore blocks in the Rathlin basin. The Rathlin basin is an early Mesozoic half graben; analogues to the play types in this basin are seen in Morecambe Bay and Wytch Farm.

In 2012, Providence acquired a Full Tensor Gradiometry (FTG) and magnetic airborne survey over its acreage. Initial processing of this data revealed the presence of five FTG anomalies. An initial P50 volumetric estimate of the primary FTG anomaly, the "Polaris Prospect" indicates an in-place prospective resource potential of ca. 530mmboe. An exploration well is required to confirm the presence of hydrocarbons in commercial quantities. Given its near-shore location, the Polaris prospect could be drilled from an onshore Northern Ireland location; the drilling costs are estimated at $8m (gross). Providence is already in discussions to get a farm-in partner with a view to drilling a well in 2014.

## Operational and Financial targets

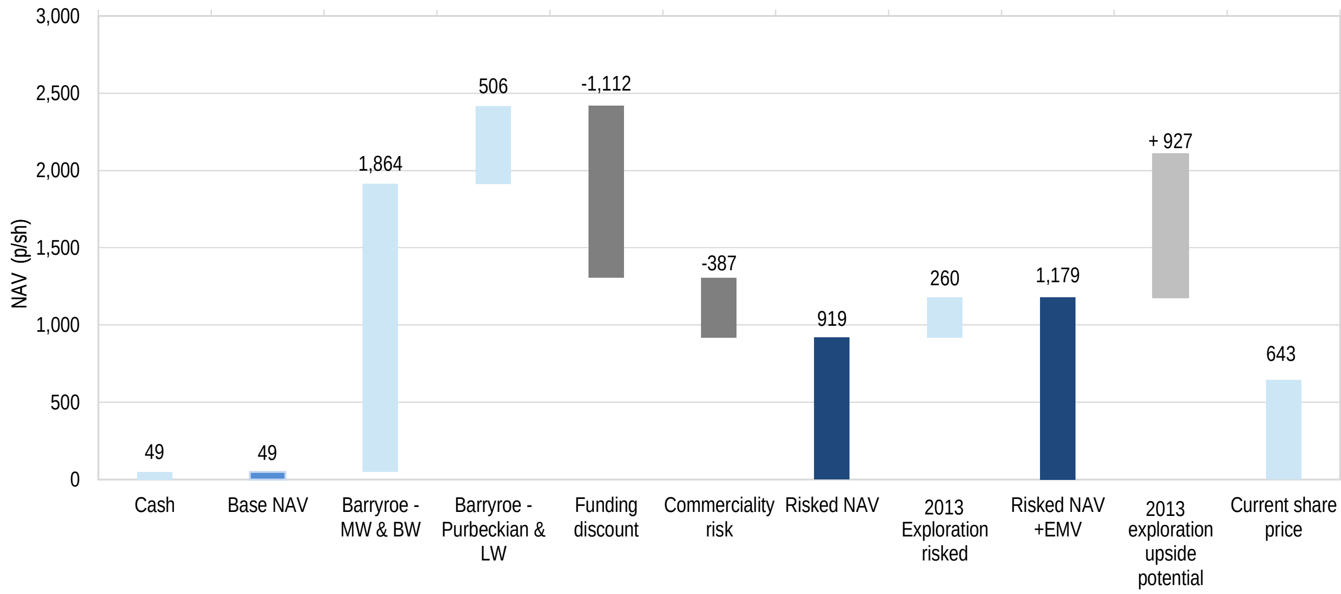
The targets for the company are based on the implementation of the multi-basin drilling program offshore Ireland. With the pending sale of the UK assets, Providence no longer has production or cash flow targets because it is now a pure play Ireland focused exploration and appraisal company.

Targets for 2013 include the farming out of Barryroe, the drilling of exploration wells at Dunquin and Kish Bank (Dalkney) and the drilling of an appraisal well at Spanish Point. 2014 targets include the drilling of an exploration well at Rathlin and an appraisal well at Dragon.

# Valuation

Our risked NAV for Providence Resources stands at 919p/sh with 260p/sh of risked exploration upside based on a $95/bbl long term oil price assumption. Barryroe is the biggest component of the valuation - around 78% of our risked NAV + EMV on our estimates.

**Figure 14: Providence Resources valuation - sum of the parts**




*Source: Oriel Securities estimates*

In our valuation model, we are carrying 280mmboe recoverable resources for Barryroe based on an assumption of 31% recovery factor for the Middle Wealden & Basal Wealden sands and 10% recovery factor for the Purbeckian and Lower Wealden sands.

**Figure 15: Risked NAV summary**

| Fields | CoS (%) | Net resources (mmboe) | NPV US$/boe | NAV ($m) | NAV (p/share) |
|---|---|---|---|---|---|
| Cash balance | | | - | 50 | 49 |
| **Base NAV** | | | | **50** | **49** |
| Barryroe (MW & BW) | 75 | 224 | 4.2 | 701 | 681 |
| Barryroe (Purbeckian & Lower Wealden) | 75 | 62.4 | 4.2 | 195 | 190 |
| **Appraisal NAV** | | | | **897** | **870** |
| **Total risked NAV** | | | | **947** | **919** |

*Source: Oriel Securities estimates*

**Figure 16: EMV summary**

| Field/prospect | Net Resources (mmboe) | CoS (%) | Value ($/bbl) | Unrisked EMV ($m) | Risked EMV ($m) | Unrisked EMV p/share | Risked EMV p/share |
|---|---|---|---|---|---|---|---|
| Dunquin | 272 | 17 | 2.1 | 568 | 97 | 551 | 94 |
| Dalkney Island | 125 | 20 | 4.2 | 522 | 104 | 506 | 101 |
| Spanish point | 32 | 50 | 4.2 | 134 | 67 | 130 | 65 |
| **Total EMV** | **429** | | | **1,223** | **268** | **1,187** | **260** |

*Source: Oriel Securities estimates*

## Underlying valuation based on a $8.4/boe estimate for Barryroe

We ran a full field-life valuation on Barryroe and arrived at an NPV/bbl of $8.4/bbl. The key assumptions used in the modeling are shown in the table below:

**Figure 17: Barryroe - field modelling assumptions**

| Project parameter | Assumption |
|---|---|
| First Oil | mid 2018 |
| Plateau production rate | 80mboed |
| Capex | $5bn |
| Fixed Opex | $75m |
| Variable Opex | $6/bbl |
| Long term Oil price | $95/bbl |
| Oil price realisation | 5% discount to Brent |
| WACC (%) | 10% |

*Source: Oriel Securities estimates*

In our valuation model, we have assumed an operating efficiency of 70% during plateau production period to reflect possible operational challenges such as a longer production ramp up after start-up, and greater unplanned losses due to the waxy nature of the Barryroe crude and potential compartmentalisation of the reservoir. Also, we have assumed an average oil price realisation at a 5% discount to our long term oil price to capture higher transportation costs of the crude – from Ireland to other destinations. Our estimate of the NPV/bbl value of the Barryroe discovery is $8.4/bbl based on these assumptions.

## But a farminee would try to acquire a stake for less - we have assumed a 50% farm-in discount

Since Providence currently does not have enough funds to commit to the development of the Barryroe field itself, it will try to bring in an industry partner through the farm-out. Any company coming in would like to acquire the stake at a discount to the fair value. We have applied a farm-in or dilution discount of 50% to the valuation to reflect this. Hence, we assume a $4.2/boe acquisition price for the Barryroe discovery. Our assumption of a 50% farm-in discount is in line with our estimate of the farm-in discount in the Sea Lion farm-out deal *($5.6/boe in our Sea Lion DCF model and $3/boe is our estimate of the implied value of Sea Lion in the farm-out deal)*

## Assumed a 75% probability of a farm-out deal happening on a $4.2/boe valuation

We have estimated a 75% probability of a successful Barryroe farm-out reflecting the possible operational challenges and development funding commitment involved. It also captures the commerciality risk of a field in this stage of the E&P cycle - Barryroe is still in the appraisal stage and a field development plan is not yet in place.

## Sensitivity to Oil price and WACC

We have carried out a sensitivity analysis of Providence’s valuation to oil price and WACC. The results are shown in the table below:

**Figure 18: Sensitivity analysis of Risked NAV + EMV to oil price and WACC**

| WACC | Oil price | | | |
|---|---|---|---|---|
| | $70/bbl | $95/bbl | $110/bbl | $130/bbl |
| 9% | 716p/sh | 1346p/sh | 1722p/sh | 2221p/sh |
| 10% | 611p/sh | 1179p/sh | 1517p/sh | 1965p/sh |
| 12% | 440p/sh | 903p/sh | 1178p/sh | 1543p/sh |

*Source: Oriel Securities estimates*

We estimate that the breakeven oil price for the Barryroe field is $46/bbl.

# Funding

E&P is a highly capital intensive industry. Pure play explorers such as Providence Resources that do not generate cash flow from a production base must fund their drilling and field development programmes either externally, perhaps through new equity or debt, or by farm-outs of existing positions.

### Fully funded for the 2013 drilling program

At the end of 2012, Providence had around $30m cash available according to the company. The proceeds from the sale of its UK assets to IGas are around $66m; company guidance is that it will close this deal by end February 2013. After taking into account the Deutsche Bank debt of just under $44m, the company could have around $50m net cash available by end February 2013. We estimate that the cost of the 2013 exploration programme and overheads till end 2013 will be in the range of $43m to $46m (refer Figure 19). This implies that Providence Resources could meet its capital expenditure requirements till the end of the farm-out process if there aren't any major cost overruns in the drilling activities on Dunquin or on Dalkey Island.

**Figure 19: Cash position**

| Cash and debt balances | ($m) |
|---|---|
| Debt as at end 2012 | 44 |
| Cash as at end 2012 | 30 |
| Net debt as at end 2012 | (14) |
| | |
| Cash from sale of UK assets | 66 |
| Net cash as at end 1Q '13 | 52 |
| | |
| Exploration capex on Dunquin | $12 to $13m net |
| Exploration capex on Dalkey island | $5 to $6m |
| Exploration capex on Spanish point | $20m (capped) net to PVR; if Chrysoar exercise option and buy back 8%, then drilling costs capped at $13.6m |
| Overheads | 6.5 |
| Total - 2013 exploration capex and overheads | $43m to $46m |

*Source: Providence Resources, Oriel Securities estimates*

### Potential to raise additional funds through the farm-out process

We think that Providence will try to secure some cash, apart from a full carry till first oil, through the Barryroe farm-out. In our model, we have assumed that Providence Resources will secure around $100m and a full carry till first oil in return for 40% to 45% equity (out of 80% equity) in its licence.

A validation of the commerciality of the Barryroe discovery, through a successful farm-out, should facilitate better access to the equity markets or debt markets for Providence.

### Failure to farm-out Barryroe could result in minimal access to new funds

In a worse case scenario, If Providence is unable to farm-out the Barryroe discovery it will be difficult for it to fund the Barryroe development itself using its preferred development concept, in our opinion. Failure to secure an industry validation of the commerciality of the Barryroe field could limit Providence's access to equity and debt markets.

## Attractive farm-in opportunity/M&A potential

### Providence Resource's portfolio could be attractive to a new entrant to the offshore Ireland basins

We believe that Offshore Ireland is emerging as an exploration hotspot for oil and gas companies due to an attractive combination of factors - proven hydrocarbon systems, benign operating environment, relatively low government take, underexplored basins and geo-political stability.

With the largest holding of licences in Ireland, including a stake in the Barryroe oil field, Providence Resources could be attractive as an M&A target to a company trying to enter the offshore Ireland basins. The Barryroe farm-in opportunity is also an attractive opportunity to enter the Celtic Sea basin in our view.

Providence's portfolio, which is dominated in value by discoveries and includes prospective licences, could be an attractive package of assets for a company entering Ireland - the discoveries could give a kick-start to the entrant and the exploration licences could provide the opportunity for further growth. Providence's licences would be attractive to independent E&P companies keen to grow through the drill bit. We have assumed a 75% probability of a successful Barryroe farm-out.

Field development of the Barryroe oil discovery could also be a good fit with Petrofac's IES business model. A risk sharing deal could be structured, similar to the deal with Bowleven, in which Providence could get a carry to first oil in return for a portion of the cash flows after first oil.

## What if the Barryroe farm-out is unsuccessful

In the event of an unsuccessful farm-out, we think that Providence's Plan B would depend on the feedback from the participants in the farm-out process.

If concerns about prospective volumes or flow assurance issues can be addressed by a low cost extension of the appraisal programme (e.g. a couple of additional production flow tests to mitigate concerns around waxy nature of the crude or an EWT to mitigate concerns around the compartmentalisation of the reservoir), that could be an option.

Significant future capital spending on the Barryroe field development can be reduced by bringing in more than one partner, if they are interested.

We can also envisage a scenario where Providence could try to develop the Barryroe field as a standalone operator with a low capex, suboptimal, phased development concept; however we think that this would be the least preferred option for the shareholders.

A risk sharing deal could also be structured, with a company such as Petrofac, in which Providence could get a carry to first oil in return for a portion of the cash flows after first oil.

If Providence is unable to farm-out the Barryroe discovery we think that it will be difficult for Providence to fund the Barryroe development using its preferred development concept by accessing the equity and/or debt markets.

# Key risk factors

## Barryroe farm-out is critical for value realisation and liquidity

The Barryroe discovery is likely to be a commercially viable field, in our opinion. In our valuation model, we have assumed a 75% probability of success for Providence to successfully farm-out its Barryroe development.

In a worse case scenario, if Providence is unable to farm-out the Barryroe discovery, we think that it will be difficult for it to fund the Barryroe development itself using its preferred development concept. Failure to secure an industry validation of the commerciality of the Barryroe discovery could limit Providence's access to equity and debt markets in our opinion.

As operator of the Barryroe field, Providence is currently the main source of information on the Barryroe field. There is a risk that other oil and gas companies that participate in the farm-out process do not agree with Providence's view on the commerciality of the field based on the due diligence of the information in the dataroom, which probably could be much more detailed than that available in the public domain.

## Possibility of a drawn out farm-out process

Apart from the drilling catalysts, a probable farm-out announcement in mid-2013 would be a major catalyst on this stock. We believe that the Barryroe farm-out process could take between 3 to 9 months (developing the marketing flyer, compiling the dataroom, executing confidentiality agreements with interested parties, supporting the due-diligence analysis of the participants, commercial negotiations and finally executing the sale & purchase agreement).

If the due diligence or commercial negotiations are drawn out then there is a risk that this major catalyst might not occur in 2013.

## Exploration risk

Providence's 2013 drilling program is targeting 400mmboe to 450mmboe net unrisked prospective resources with three wells. The expected capital spend on this drilling programme is $43m to $46m. It includes high risk exploration activities which could result in disappointing exploration results.

## Exposure to oil price

The company is exposed to commodity pricing risk; changes in oil price can change the underlying value of its assets. We have run sensitivities to Providence Resource's risked NAV + EMV at different oil prices (from $70/bbl to $130/bbl), see Figure 18. All other things held constant, Providence's risked NAV + EMV reduces to 611p/sh at $70/bbl. We estimate that the breakeven oil price for the Barryroe field is $46/bbl.

## Single country and single project risk

Most of Providence Resource's valuation is based on the Barryroe oil discovery in Ireland. We think that Barryroe is likely to be a commercially viable field. We have applied a 63% cumulative discount to reflect the possible dilution and commerciality risk.

Ireland has one of the most attractive oil and gas fiscal regimes in the world. The government take on the Barryroe field is 26% on our estimates. This is typical of a relatively frontier unproven region looking to incentivise oil exploration. Given the generous terms and assuming high oil prices are sustained through the development of any discoveries, there is a risk that supplementary taxes could be introduced in the future when a petroleum industry is established.

# Appendix I – Board of Directors

There is a wealth of experience in Providence Resources in Irish exploration and production activities. We believe that this is a good fit with its strategy of focusing on Irish oil and gas exploration and production activities.

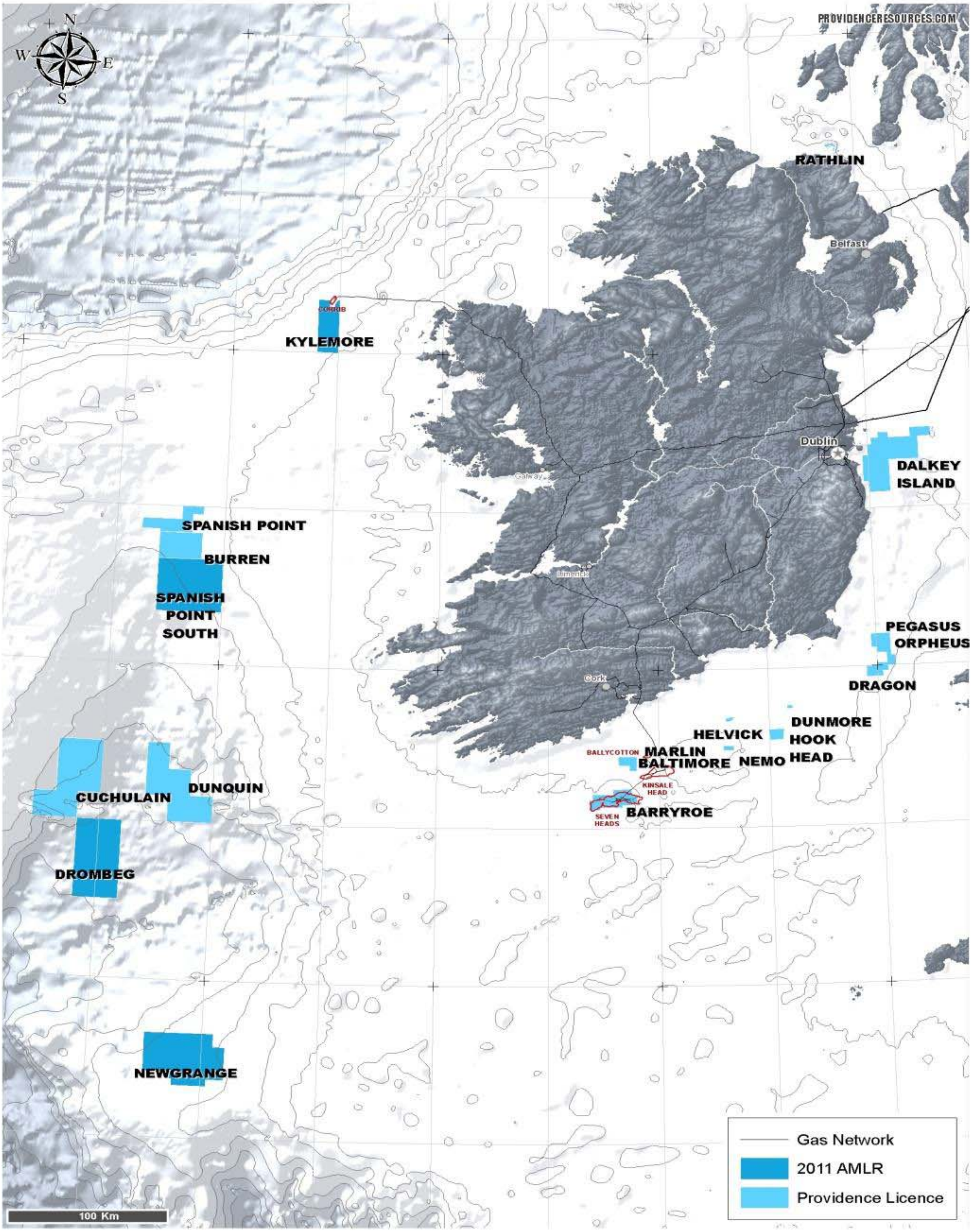
**Figure 20: Providence Resources - Board of Directors**

| Board of Directors | Position | Career profile |
|---|---|---|
| Dr. Brian Hillery, B. Comm., MBA, Ph.D | Chairman | Brian Hillery has served as Chairman of Providence since the incorporation of the Company. He is currently a member of the National Pensions Reserve Fund Commission. A former Professor at the Graduate School of Business, University College Dublin, he has also served as a member of the Irish Parliament as a TD and Senator (1977-1994). He was an Executive Director of the European Bank for Reconstruction and Development (EBRD) London (1994-1997) and was Non-Executive Chairman of both UniCredit Bank Ireland PLC (1999-2008) and Independent News and Media plc (2004-2011). |
| Tony O'Reilly, BA | Chief Executive | Tony O'Reilly has been Chief Executive of Providence Resources P.l.c. since 2005, having founded the Company in 1997 and he has served as a Director since its incorporation. He has previously worked in mergers and acquisitions at Dillon Read and in corporate finance at Coopers and Lybrand, advising natural resource companies. He served as Chairman of Arcon International Resources P.l.c. (having been Chief Executive from 1996 to 2000) until April 2005 when Arcon merged with Lundin Mining Corporation. |
| John O'Sullivan, B.Sc., M.Sc., M.T.M. | Technical Director | John O'Sullivan is a geology graduate of University College, Cork and holds a Masters in Applied Geophysics from the National University of Ireland, Galway. He also holds a Masters in Technology Management from the Smurfit Graduate School of Business at University College, Dublin and is currently completing a dissertation leading to a Ph.D in Geology at Trinity College, Dublin. He is a Fellow of the Geological Society and a member of the Petroleum exploration Society of Great Britain. |
| Lex Gamble, BA, MBA | Non-Executive Director | Lex Gamble was appointed as a Non-Executive Director of the Company in August, 2005. Mr. Gamble holds a Bachelor of Arts Degree from the University of Washington, and a Masters Degree from Harvard Business School. He is a Director of Cardiac Insights Inc. and a former director Harris Private Bank NA, Northwestern Trust Co., Keystone Capital Corp., General Nutrition Corp. and Ashford Castle. He has been an investment banker for over 35 years serving as a Managing Director of Smith Barney, Morgan Grenfell and Kidder Peabody. He has provided strategic advice to more than 200 U.S. and international companies, including several in the FTSE 100 and Fortune 500. |
| James S.D. McCarthy, MBA | Non-executive Director | James McCarthy was appointed as a Non-Executive Director of the Company in May 2005 Mr McCarthy holds a Bachelor Degree in Civil Law, an MBA from the University of Pittsburgh and is a qualified solicitor. He is Chief Executive of Nissan Ireland Ltd and a Director of Corporate Finance Ireland Limited, Windsor Motors Limited and Rockall Technologies Limited and a number of other companies. Mr McCarthy is a former Director of ARCON International Resources P.l.c |
| Dr Philip Nolan, B. Sc., Ph.D | Non-executive Director | Philip Nolan became a Non-Executive Director of the Company in May 2004. Dr. Nolan was CEO of Eircom Plc from 2002 to 2006. He is currently Chairman of J Laing PLC. He is also a Non-Executive Director of the Ulster Bank Group and a former Director of De La Rue PLC. He is Chairman of the Irish Management Institute and is a member of the board of the Ireland Fund. Dr. Nolan, graduated from Queen's University in Belfast with a BSc and a Ph.D in geology and has an MBA from the London Business School. |
| Philip O'Quigley, B. Comm | Finance Director | Philip O'Quigley was Finance Director of Providence Resources from June 2008 until his appointment as Chief Executive Officer of Falcon Oil & Gas in May 2012. Philip continues to serve the company in his capacity as non-executive director. Philip has over 20 years' experience in finance positions in the oil and gas industry. His career spans a number of London and Dublin listed resources companies. Philip is a fellow of the Institute of Chartered Accountants in Ireland and qualified as a Chartered Accountant with Ernst & Young. |

*Source: Providence Resources*

# Appendix II – Ireland licences

**Figure 21: Ireland licences**




Source: Providence Resources

# Appendix III - Exploration prospects

**Figure 22: Exploration prospects**

| Asset | Basin | Operator | (%) | Partners | Well status |
|---|---|---|---|---|---|
| **FEL 3/04** | | | | | |
| Dunquin | South Porcupine | ExxonMobil | 16.0 | ExxonMobil/ Repsol/ENI/ Sosina | Q1 2013 well planned |
| **FEL 1/99** | | | | | |
| Cuchulain | South Porcupine | ENI | 3.2 | ExxonMobil/ENI/ Sosina | tbc |
| LO 11/9 | | | | | |
| Drombeg | South Porcupine | Providence | 80.0 | Sosina | tbc |
| FEL 4/08 | | | | | |
| Cama | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| Wilde | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| Beehan | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| Rusheen | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| Costelloe | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| Shaw | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| Synge | Porcupine | Providence | 32.0 | Chrysaor/Sosina | tbc |
| LO 11/2 | | | | | |
| Spanish Point South | Porcupine | Providence | 32.0 | Chrsyaor/Sosina | tbc |
| LO 11/12 | | | | | |
| Kylemore | Slyne Trough | Providence | 66.6 | First Oil | tbc |
| Shannon | Slyne Trough | Providence | 66.6 | First Oil | tbc |
| LO 11/11 | | | | | |
| Newgrange | Goban Spur | Providence | 40.0 | Repsol/Sosina | tbc |
| SEL 2/11 | | | | | |
| Dalkey Island | Kish Bank | Providence | 50.0 | Petronas | Q3/Q4 2013 well planned |
| SEL 1/07 | | | | | |
| Pegasus | St George's Channel | Providence | 100.0 | | tbc |
| Orpheus | St George's Channel | Providence | 100.0 | | tbc |
| Dionysus | St George's Channel | Providence | 100.0 | | tbc |
| PL 5/10 (UK) & PL1885 (UK) | | | | | |
| Rathlin Basin | Rathlin | Providence | 100.00 | | Q1 2014 well planned |

*Source: Providence Resources*

# Appendix IV – Discoveries

**Figure 23: Discoveries**

| Asset | Basin | Operator | (%) | Partners | Well status |
|---|---|---|---|---|---|
| SEL 1/11 | | | | | |
| Barryroe | Celtic Sea | Providence | 80.0 | Lansdowne | Drilled in 2012 |
| SEL 2/07 | | | | | |
| Hook Head | Celtic Sea | Providence | 72.5 | Atlantic/Sosina | Drilled in 2008 |
| Dunmore | Celtic Sea | Providence | 72.5 | Atlantic/Sosina | Drilled in 2008 |
| Helvick | Celtic Sea | Providence | 62.5 | Atlantic/Sosina/ Lansdowne | Drilled in 2000 |
| FEL 2/04 | | | | | |
| Spanish Point | Main Porcupine | Providence | 32.0 | Chrysaor/Sosina | Q2/Q3 2013 well planned |
| Burren | Main Porcupine | Providence | 32.0 | Chrysaor/Sosina | Drilled in 1979 |
| SEL 1/07 (IRL) & PL1930 (UK) | | | | | |
| Dragon | St George's Channel | Providence | 100.0 | | Q1 2014 well planned |

*Source: Providence Resources*

# Appendix V – Ownership structure

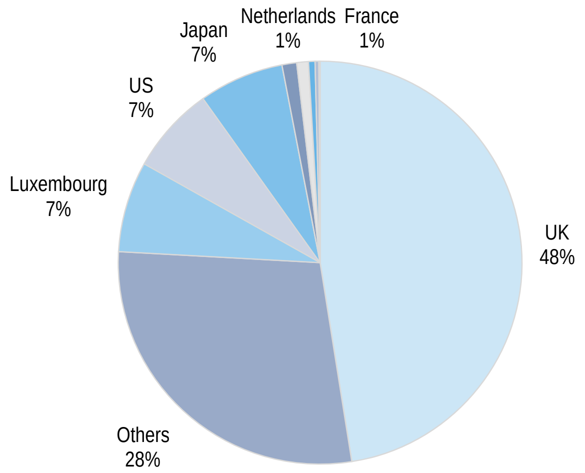
The top 10 shareholders of Providence Resources together hold around 52% of the company. Tony O'Reilly, the CEO of Providence Resources, comes from the family of the largest shareholder of the company.

**Figure 24: 10 Largest shareholders**

| Investor | Ownership (%) |
|---|---|
| Sir Anthony O'Reilly | 15.45 |
| JP Morgan Chase & Co | 5.94 |
| Henderson Global Investment Limited | 3.88 |
| BlackRock Investment Management (UK) Limited | 10.80 |
| F & C Asset Management plc | 4.02 |
| Capital Group Companies Inc | 3.87 |
| JP Morgan Investment Management | 3.83 |
| HSBC Investment Funds (UK) Ltd. | 1.66 |
| Hargreave | 1.40 |
| Artemis Investment Management Ltd. | 0.74 |

*Source: The Bloomberg Professional TM service, Providence Resources*

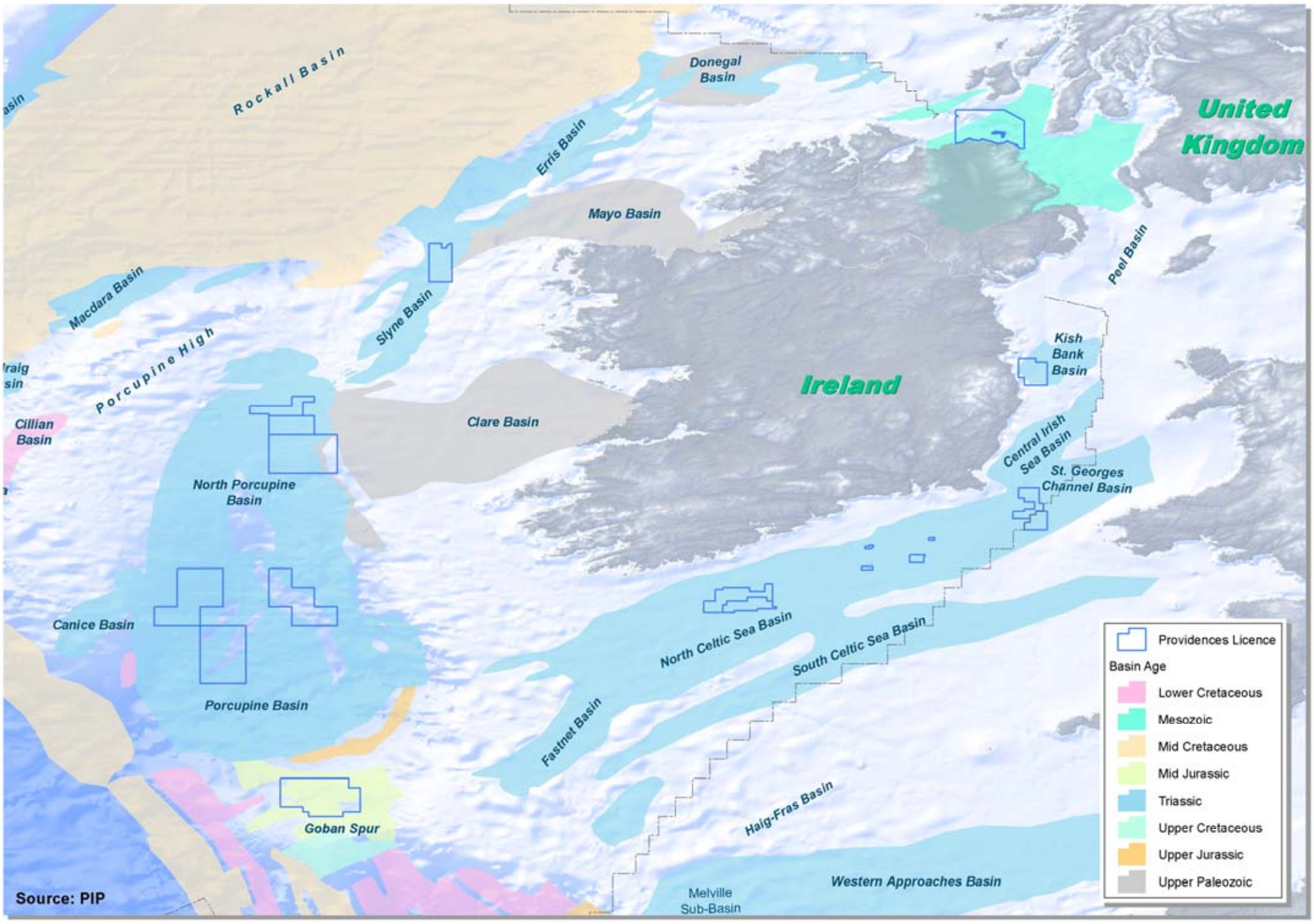
**Figure 25: Shareholder structure by country**




*Source: the Bloomberg Professional TM service*

# Appendix VI – Sedimentary basins offshore Ireland

**Figure 26: Classification of sedimentary basins offshore Ireland**




*Source: Providence Resources*

## Recommendation history

**Providence Resources PLC**

| Date | Recommendation |
|---|---|
| Initiated today: | BUY |

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