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Seismic reflections

Frack on track

The embryonic UK shale industry has received a significant vote of confidence in the last couple of weeks. The government has created a new office to handle unconventional resource regulation, begun a consultation around the fiscal regime and most importantly lifted the suspension on fracking. However, significant challenges lie ahead. If UK shale is proved to be commercial, we consider the play to be transformational to the UK energy mix. We would expect those companies with first-mover advantage, namely Cuadrilla, IGAS, Dart and Egdon, to be beneficiaries of this.

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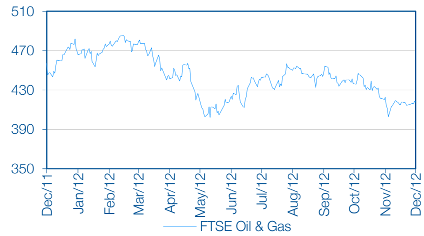

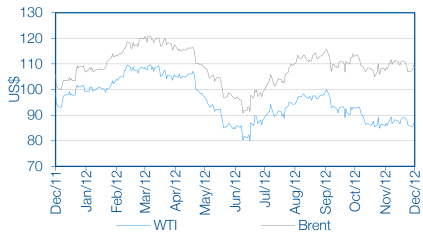

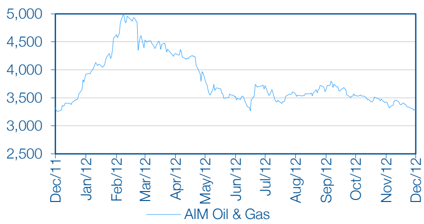

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Fracking suspension lifted

In the Autumn Statement, Chancellor George Osborne announced the creation of the Office for Unconventional Oil and Gas, to help address regulation around the potentially emerging play. He also stated that the government would consult with the industry on how to construct an appropriate fiscal regime for UK shale. In addition, the Department of Energy and Climate Change (DECC) announced on 13 December that it has lifted the suspension of fracking and in principle would be willing to accept new requests to frack.

UK shale – 20tcf of potentially recoverable resource

Shale gas could be transformational to the UK energy mix in the long term. In a report on shale gas released in April 2011, the EIA stated that the UK could have 20tcf of technically recoverable shale gas. While modest in comparison to Poland's 187tcf or France's 180tcf, it is still a substantial potential resource. The UK consumes c 3tcf of gas per year, of which c 40-50% is imported. With domestic gas production falling 57% over the last decade, without shale gas the UK will become more dependent on imports.

Reality check – significant challenges lie ahead

A plentiful supply of domestic gas is not a near-term possibility. Significant technical, commercial, political and environmental challenges await the companies that are active in this arena. A material number of expensive wells will need to be drilled to understand the type curve of each shale accumulation. The services industry must move to support this play, as we believe there would be supply issues for rigs and fracking units in north-west Europe if activity increased markedly. Comparisons to the USA shale boom may be unrealistic given the difference in geology, stratigraphy, urbanisation and mineral rights ownership. Added to this are the challenges created from permitting, site permission and environmental opposition. We also expect regulation to be a moving feast, with the government learning on the job in respect to shale regulation.

The main players to benefit – Cuadrilla, IGAS, Dart, Egdon

Overall, we consider this to be a long-term play, which will require significant capital investment and patience to develop. However, if the play emerges, we expect the first movers to benefit most, namely Cuadrilla (Private), IGAS, Dart and Egdon. In the same way that Devon Energy and Chesapeake were built out of the US shale revolution, we could see a similar transformation of the companies already involved in UK shale.

Exhibit 1: Best and worst performers

1 week					
No.	Best performers	% change	No.	Worst performers	% change
1	GULFSANDS PETROLEUM PLC	17.5%	1	SOUND OIL PLC	-17.8%
2	PETREL RESOURCES PLC	11.2%	2	URALS ENERGY PUBLIC CO LTD	-12.0%
3	GASOL PLC	8.8%	3	FRONTERA RESOURCES CORP	-11.2%
4	BANKERS PETROLEUM LTD	7.0%	4	PETRO MATAD LTD	-7.8%
5	ROCKHOPPER EXPLORATION PLC	7.0%	5	GULF KEYSTONE PETROLEUM LTD	-6.9%

1 month					
No.	Best performers	% change	No.	Worst performers	% change
1	ENEGI OIL PLC	26.3%	1	FALKLAND OIL & GAS LTD	-51.4%
2	EGDON RESOURCES PLC	25.4%	2	ANTRIM ENERGY INC	-29.1%
3	VICTORIA OIL & GAS PLC	7.2%	3	INDEPENDENT RESOURCES PLC	-28.6%
4	CHARIOT OIL & GAS LTD	6.7%	4	ASCENT RESOURCES PLC	-27.5%
5	LENI GAS & OIL PLC	6.3%	5	ROXI PETROLEUM PLC	-25.0%

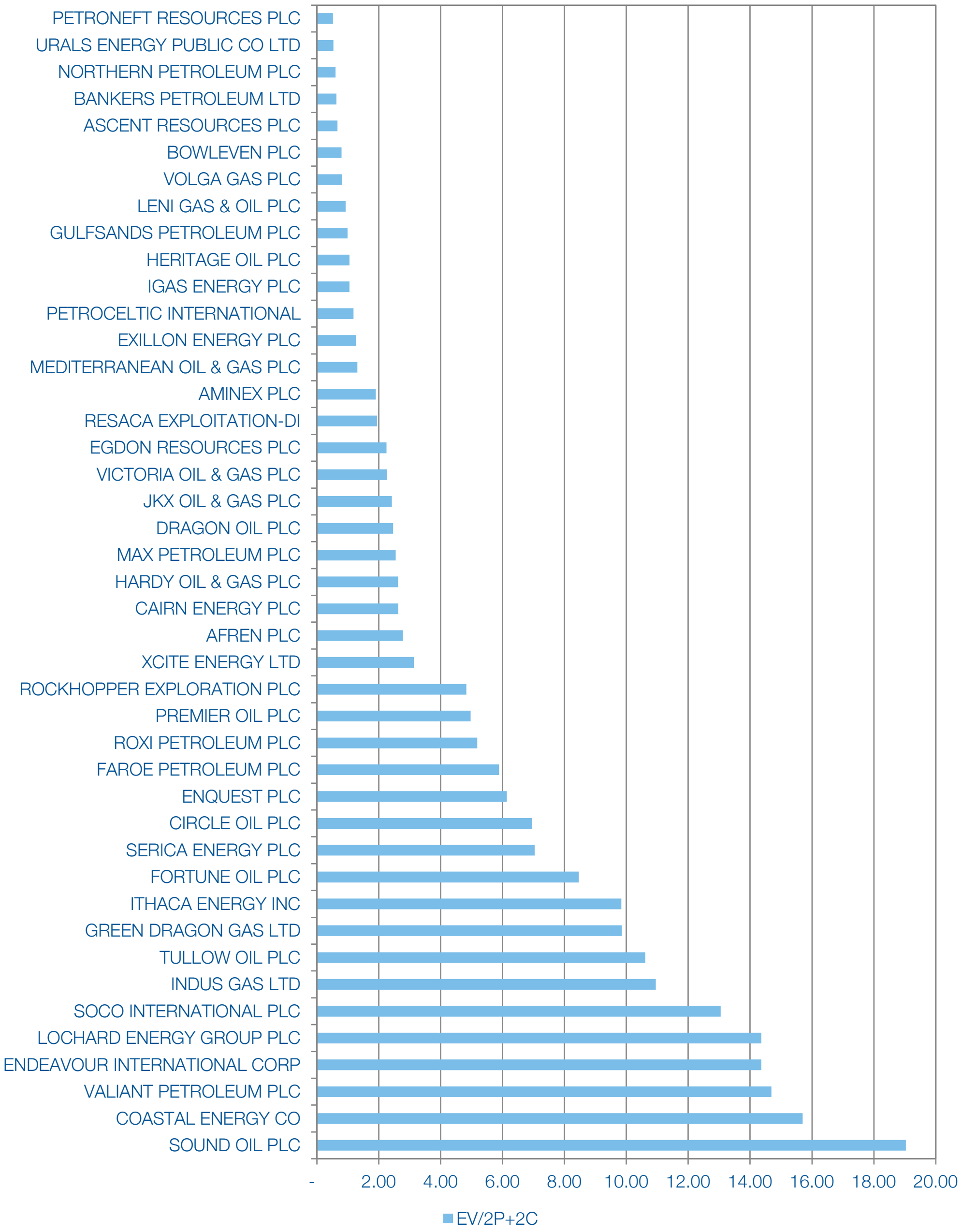
3 months					
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	308.8%	1	FALKLAND OIL & GAS LTD	-57.2%
2	SOUND OIL PLC	117.6%	2	GASOL PLC	-36.5%
3	NIGHTHAWK ENERGY PLC	103.2%	3	RESACA EXPLOITATION-DI	-35.7%
4	EUROPA OIL & GAS HOLDINGS	88.1%	4	ENDEAVOUR INTERNATIONAL CORP	-35.5%
5	LENI GAS & OIL PLC	83.7%	5	INDEPENDENT RESOURCES PLC	-35.3%

6 months					
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	275.7%	1	BORDERS & SOUTHERN PETROLEUM	-72.9%
2	LENI GAS & OIL PLC	79.5%	2	INDEPENDENT RESOURCES PLC	-71.4%
3	EXILLON ENERGY PLC	75.8%	3	FALKLAND OIL & GAS LTD	-66.5%
4	MEDITERRANEAN OIL & GAS PLC	73.5%	4	RESACA EXPLOITATION-DI	-65.8%
5	EUROPA OIL & GAS HOLDINGS	64.6%	5	MAX PETROLEUM PLC	-62.6%

1 year					
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	183.7%	1	INDEPENDENT RESOURCES PLC	-82.4%
2	AMERISUR RESOURCES PLC	141.4%	2	PETRO MATAD LTD	-77.1%
3	LENI GAS & OIL PLC	139.4%	3	RESACA EXPLOITATION-DI	-76.0%
4	NIGHTHAWK ENERGY PLC	95.2%	4	PETRONEFT RESOURCES PLC	-73.1%
5	KEA PETROLEUM PLC	73.0%	5	CHARIOT OIL & GAS LTD	-71.4%

Source: Bloomberg

Exhibit 2: EV/2P + 2C rankings



Source: Bloomberg, company releases, Edison Investment Research

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