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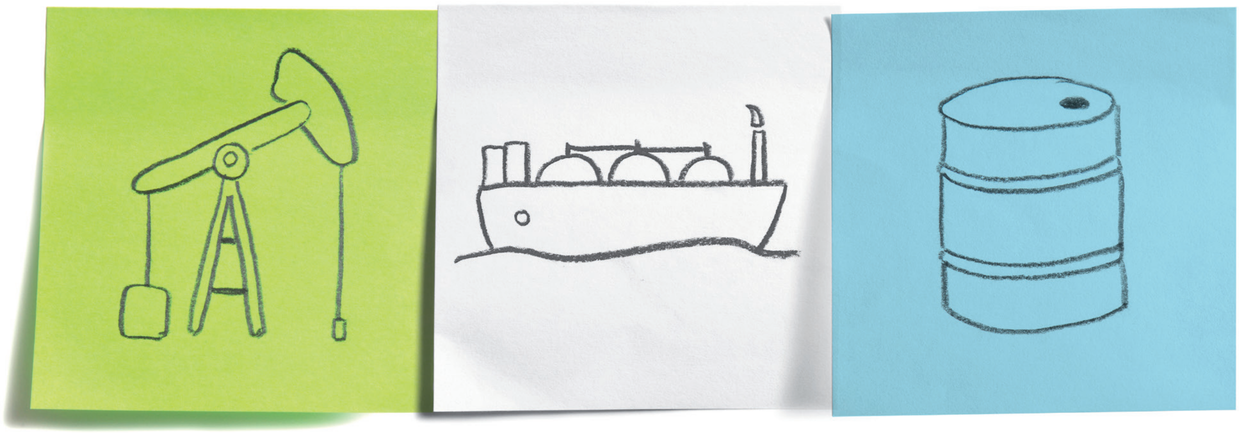
Key extracts
UK upstream independents league table 2014



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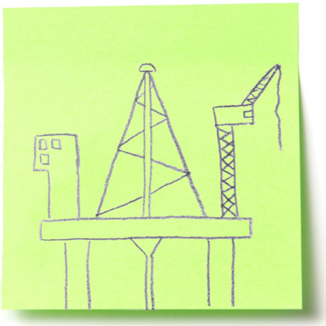

If 2013 was challenging for UK upstream independents, the second half of 2014 brought unforeseen difficulties. After nearly four years of relative stability, with oil prices remaining above the $100 per barrel mark, the Brent crude oil price fell dramatically by almost 50 per cent between June and the end of December 2014.

The price drop reflected global oil and gas economics in action: increasing supplies outpacing slowing demand growth. Against a backdrop of lower demand growth in developed countries and China, US production increased from five million barrels per day (bopd) in 2008 to nine million bopd in 2014. In addition, in 2014 Russian production was nearing high levels last seen in the late 1980s and Iranian output also exceeded expectations. OPEC countries could not reach an agreement on production cuts and Saudi Arabia, which has historically acted as the swing producer within OPEC, abandoned its traditional role in favour of protecting its global market share by continuing production.

There is a wide range of views on how long oil prices could hover at current levels and where they could be heading. A company's behaviour is driven by its own unique position and operating cost thresholds, which in turn are likely to drive investor response. Many exploration and production companies have reacted to falling oil prices by cutting capital investment and reducing their work force. Small and medium-sized companies have found themselves more exposed to the crisis due to weaker balance sheets, which have had an adverse impact on investor confidence and their share price.

Methodology
The UK upstream independents league table has been compiled from the December 2014 London Stock Exchange (LSE) List of All Companies and applied the following selection criteria:

- Sector: Oil & Gas Producers
- Sub-sector: Exploration & Production
- Country of incorporation: UK (GB, GG, IM and JE)
- Ordinary shares: Yes
- Market capitalisation: £ value highest to lowest for top 25 companies
- A direct comparison has been made between end December 2013 and end December 2014.

Exclusions: We excluded one company whose activities are not primarily focused on oil and gas exploration and production despite the above categorisation. The exclusion was based on principal activities and a review of the business sections as described in the company's latest Annual Report and Accounts.

The total market capitalisation of the top 25 companies fell 47 per cent from £22.5 billion at the end of 2013 to £11.8 billion at the end of 2014. With a decline of £4 billion, Tullow Oil accounted for the largest single drop in company market value, while the combined market capitalisation of Afren, Indus Gas and Ophir was reduced by £3.5 billion between the end of 2013 and 2014.

Tullow Oil continues to lead the *UK upstream independents league table* since it was first published in 2009. Cairn Energy and SOCO International are ranked second and third, both climbing up four places from 2013.

Funding

Access to finance was challenging even before June 2014, but the sliding oil price has further damaged the UK upstream independents' capability to raise funds.

During the financial crisis banks' ability to lend was reduced, which had a knock-on effect on many oil and gas companies as bank lending was their primary source of financing. While new legislation forced banks to rebuild their balance sheets and introduce tighter lending controls, innovative debt structures and creative financing solutions started to fill the widening funding gap.

The lack of major oil and gas discoveries in recent years is one factor that has led banks and other investors to adopt a more cautious approach to funding in this sector, especially in relation to equity for exploration projects. This has forced a number of independents to farm out part of their assets or sell non-core assets to fund exploration programmes. Ophir Energy's acquisition of Salamander Energy is an example of a full merger where an explorer's portfolio has been matched with a production company's capital. However, many other assets have been on the market for quite some time, suggesting that the sellers either did not achieve their desired price or that buyers are waiting for a further price drop.

Despite these challenging conditions, companies with an attractive asset portfolio, solid management and strong project execution capabilities were able to secure debt in the first half of 2014. For example, a handful of companies, including Tullow Oil, Nostrum Oil & Gas and EnQuest, issued bonds in early 2014, albeit at an increased coupon rate compared with prior years. However, as oil prices started to slide, these opportunities quickly disappeared.

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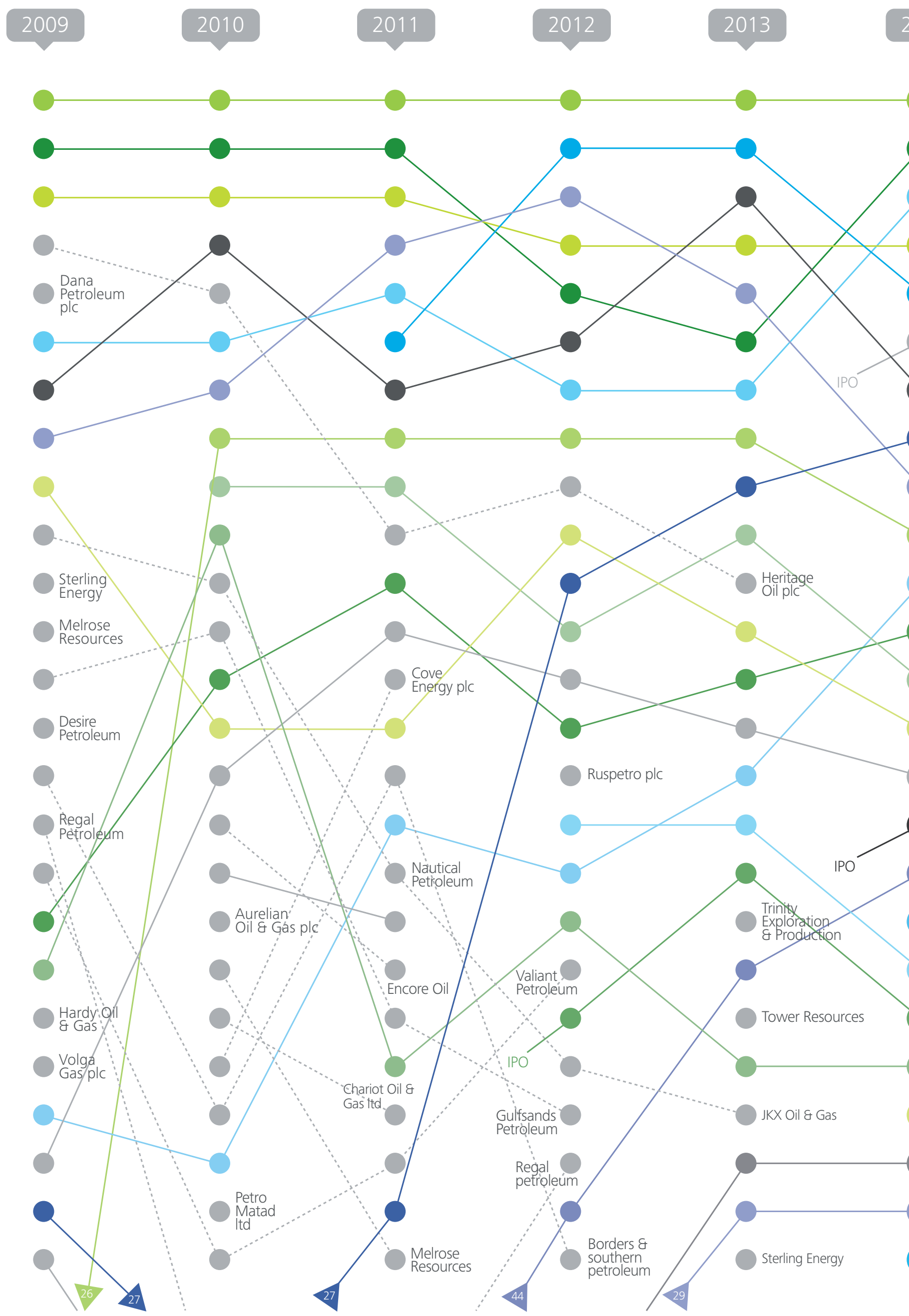


		Market	Cap £m
1	Tullow Oil plc	Main	3,752
2	Cairn Energy plc	Main	1,029
3	Soco International	Main	1,007
4	Premier Oil plc	Main	863
5	Ophir Energy plc	Main	816
6	Nostrum Oil & Gas plc	Main	790
7	Afren plc	Main	514
8	Amerisur Resources plc	AIM	451
9	Indus Gas ltd	AIM	444
10	Enquest plc	Main	284
11	Fortune oil	Main	247
12	Exillon Energy plc	Main	242
13	Rockhopper Exploration	AIM	192
14	Salamander Energy plc	Main	165
15	Faroe Petroleum plc	AIM	162
16	Hurricane Energy plc	AIM	115
17	Parkmead Group(the)	AIM	111
18	Igo Energy plc	AIM	108
19	Igas Energy plc	AIM	104
20	Eland Oil & Gas plc	AIM	103
21	Bowleven	AIM	101
22	Roxi Petroleum plc	AIM	71
23	Nighthawk Energy plc	AIM	70
24	President Energy plc	AIM	66
25	Volga Gas plc	AIM	60

Total market cap '14

11,868

Moving into the top 25:

- Nostrum Oil & Gas – in at 6 following its listing in June 2014
- Hurricane Energy – in at 16 following its listing in February 2014
- LGO Energy – in at 18 (up from 50)
- Roxi Petroleum – in at 22 (up from 34)
- Volga Gas – in at 25 (up from 27).

Falling out of the top 25:

- Heritage Oil left the top 25 after being acquired by Energy Investment Global
- Trinity Exploration & Production – down to 38 (from 18)
- Tower Resources – down to 39 (from 20)
- JKX Oil & Gas – down to 43 (from 22)
- Sterling Energy – down to 30 (from 25).

Note: Despite being included in the LSE list of oil and gas producers, Quadrise Fuels International has been excluded from the league table. This is because it is an oilfield services company.

Although the restructuring of bank balance sheets has progressed, banks now have higher capital adequacy requirements. Combined with the low price environment, this means that bank debt will only be available for the most promising companies and projects. Lower asset values and higher credit risk default could make renegotiating debt more challenging, particularly for companies with high debt levels. With price decks used for Reserve Based Lending (RBL) tracking the falling oil price, highly leveraged companies relying on RBL facilities could have found their capability to borrow significantly reduced.

Banks will now be considering their approach to funds they have already lent to oil and gas companies. As the current crisis is commodity price driven and not financial in nature, banks may be more willing to engage in discussions with oil and gas companies. Banks could adopt a more supportive and long-term approach to individual companies and avoid an industry-wide restructuring.

The current low price environment could also increase the volume of 'distressed sales' as companies struggle to meet their immediate financial obligations. This could provide those with cash reserves the opportunity to buy high quality assets at reduced prices. National Oil Companies in search of resources and entrepreneurial management teams could view this as a good time to invest.

Companies entering the league table

Five companies entered the league table in 2014, two through IPOs and three through performance.

Companies entering through IPOs

Although investor appetite for oil and gas companies has noticeably weakened since the financial downturn, the stable and historically high oil price environment in the first half of 2014 provided a window of opportunity for companies to raise capital on London equity markets. However, with the oil price collapse in the second half of the year, interest in oil stocks waned and companies experienced renewed difficulty in raising capital on the London markets.

Hurricane Energy joined the AIM Market in February 2014. Following two large discoveries in West of Shetland in 2009 and 2010, the fractured basin specialist now has full ownership of 450 million barrels of 2C contingent resources. A fundraising round and proceeds from its listing helped the company to start appraisal work at its Lancaster oil discovery later in 2014.

The second company to list, Nostrum Oil & Gas, switched from Global Depositary Receipts to premium listing to improve liquidity. The Kazakhstan-based oil and gas explorer and producer joined London's Main Market in June 2014 and entered the league table at sixth place.

Other entrants

In addition to companies entering the *UK upstream independents league table* via IPOs, there were three new explorers that joined in 2014. Two of the companies, LGO Energy (previously Leni Oil & Gas) and Roxi Petroleum, were among the few that saw their market value grow over the past year.

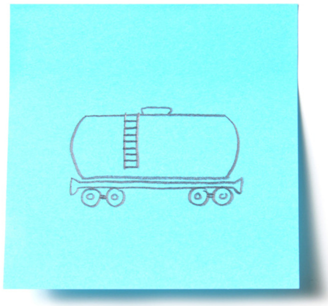
LGO Energy's market capitalisation increased seven-fold between end-2013 and end-2014, catapulting it to 18th place in the league table, up 32 places from 2013. The explorer and producer, which specialises in reactivation of mature oil fields, has assets in Trinidad and Spain. The company doubled oil production throughout 2014 as a result of successful drilling in the redeveloped Goudron field in Trinidad. Despite the low oil price environment this attracted investor interest and enabled the junior explorer to raise further funds to maintain the pace of drilling at Goudron in 2015.

Roxi Petroleum, the Kazakhstan-based oil and gas exploration and production company, climbed to 23rd place, up 12 places from 2013. During the summer, shares in the company jumped on the news of a discovery at its BNG asset in western Kazakhstan. While operational issues caused the share price to fall later in 2014, it was still double its opening price by the end of the year.

After several years of nearly making the *UK upstream independents league table*, Volga Gas entered at 25th place. The Russian exploration and production company, which has assets in the Volga region in Western Russia, caused a stir in the equity market when it put itself up for sale in June 2014. However, the proposed transaction failed to complete.

Uncertainties weighing on the North Sea

The UK government's initiative to establish a regulatory framework better suited for the next phase of the maturing basin's lifecycle got underway in 2014. The government-initiated Wood Review was published in February 2014 to provide a holistic approach to maximising the economic recovery of resources in the UK Continental Shelf. The report recommended the development of a shared strategy and the establishment of a new, independent regulator delivering this strategy. While the industry welcomed the Wood Review, it also introduced a level of uncertainty leading some companies to adopt a 'wait and see' strategy.



HM Treasury's response to the Wood Review included a fiscal review and the introduction of a new field allowance for ultra-high pressure, high temperature field clusters. A number of operators and Oil and Gas UK, the leading UK industry trade association, welcomed the allowance and expected it to enable new projects attracting multi-billion dollar investment, new jobs and opportunities for the supply chain.

However, drilling activities fell significantly in 2014 reflecting the uncertainties highlighted in the Wood review, falling oil prices and the generally challenging UK North Sea operating environment. According to the Deloitte *North West Europe End of Year Review 2014*, 40 exploration and appraisal wells were drilled offshore in the UKCS in 2014 compared with 50 in 2013. The number of field start-ups also declined from 13 fields in 2013 to six in 2014. Four of the six start-ups were eligible for the small field allowance, which suggests that the introduction of tax relief continues to support marginal field start-ups.

With the well success ratio and volume of discoveries being reduced significantly from 2009, the North Sea's significance in the global oil market is fading. The low oil price and high cost environment also increases the risk of many fields becoming uneconomic and could lead to the acceleration of decommissioning and associated loss of critical infrastructure in the basin.

Despite the challenges, the basin continues to attract operators. The 28th offshore licencing round was successfully completed, where two UK upstream independents, EnQuest and The Parkmead Group, were awarded new licences and 12 new companies entered the UK Continental Shelf for the first time.

Companies leaving the league table

In 2014, one company left the league table after being acquired. Heritage Oil was acquired by Energy Investment Global, a Qatari investment fund, in June 2014. The deal's stated aim was to diversify the investment fund's international portfolio through Heritage Oil's main asset base in Nigeria and other interests in Papua New Guinea, Tanzania, Malta, Libya and Pakistan.

Four other explorers and producers dropped out of the league table due to operational or geopolitical issues. Tower Resources saw its share prices decline on news of unsuccessful drilling at its most promising asset, the Welwitschia-1A field, in offshore Namibia in the summer of 2014. Falling oil prices and a financial dispute with the field's operator, Repsol Exploration (settled before the end of the year), kept Tower Resources' share price low for the rest of 2014.

Sterling Energy's share price also fell dramatically. This followed the explorer plugging and abandoning the Bamboo-1 well in Cameroon after no commercial hydrocarbon was found in the spring.

The crisis in Ukraine had an adverse impact on JKX's share prices in 2014. Prior to the crisis, production in the country accounted for over three-quarters of the explorer's income. JKX's share price dropped after the Ukrainian government announced that taxes on oil and gas production would double in August 2014. It fell further in December amid fears that JKX would be forced to abandon its operations in the country after the government ordered industrial customers to buy gas from Naftogaz, the state-owned company, for the next three months.

Trinity Exploration & Production, the Trinidad and Tobago-focused explorer, joined the AIM market in early 2013 but saw its share price gradually decline over 2014, which Trinity's management attributed to the challenging market conditions that surround junior explorers in particular.

Outlook

The next 12 months will test the ability of upstream independents to respond quickly to the prevailing conditions and adopt longer-term strategic measures to position their businesses more effectively in a prolonged low oil price environment.

A company's ability to cut costs meaningfully, sustainably and without harming future growth will be key to survival and success. Companies that robustly challenge and address the breadth of options available to management: financing and capital structure, portfolio maximisation, project efficiency and delivery, overhead and human resource efficiency, supply chain optimisation and tax efficiency are likely to move up the league table

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