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Davy Research

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Equity Report: Company update

Providence Resources

Price: 3.9p

Significant exploration opportunity with gas storage stability

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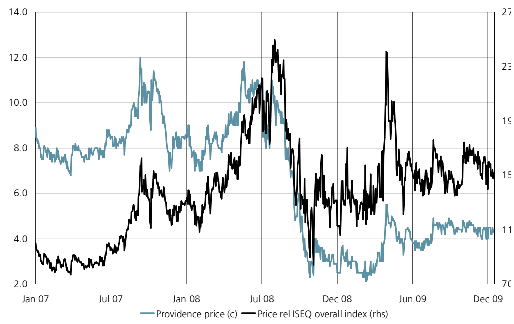
Share Price Performance



Company data

One year high/low (p)	4.8/2.1
Mkt cap (£m)	96.4
Net debt (£m)	78.6
EV (£m)	175

Recent research and research resources

Recent research and financial data on Providence Resources
Sector research and data on Resource

Looking for growth, looking for impact – gas storage and large Atlantic Margin targets provide new lease of life

- Providence could be close to making a major breakthrough in terms of scale and opportunity.
- A key factor in this assessment is the group's recent investment in gas storage offshore Ireland.
- Providence also retains a portfolio of major high-impact, high-value plays along the Atlantic margin.

Storage presents significant growth opportunity and offers new route to grow group value

- Petronas' decision to buy Marathon's assets offshore Ireland and Providence's subsequent decision to purchase a 40% share of these assets provides a significant growth opportunity.
- The investment initially involves buying existing gas production and storage, but significant expansion of the storage is planned in the longer term.
- Although the business has very different characteristics to traditional E&P, it offers a completely new route to grow the group's value.

Big targets need big wallets but also offer potentially large returns

- We think Exxon Mobil will drill Dunquin, a multi-TCF gas target along the Atlantic margin, in the next two years.
- The very large Spanish Point target could also be drilled within the same time-frame if the planned farm-out is successful.
- Our risked valuation for Providence is 14.0p (fully diluted) per share, more than 3x the current price. Unrisked, the Atlantic margin provides the opportunity for a multiple of this valuation. At the same time, gas storage offers stability and value.

Contents

Introduction

A new lease of life in the last year

- Providence has undergone significant change in recent years

In one form or another, Providence Resources has existed for nearly 30 years. Although it originally focussed almost entirely on exploration offshore Ireland, the group has in more recent years transformed itself into a diversified E&P company with operations in Ireland, the UK, the US and Nigeria.

Providence also took a strategic decision to build its oil and gas production to 5,000 bopd by 2011. To achieve this, it purchased producing assets in the UK and the US.

The group's Irish exploration activities were also reviewed following a series of disappointing results in the Celtic Sea. Consequently, we believe exploration and development activity is now likely to be based around much larger targets along the Atlantic Margin, where the group will use local knowledge and experience to retain small but still material interests by virtue of the target scale. In the Gulf of Mexico, it intends to pursue low-risk development of its US reserves.

Most recently, the group became involved in the gas production and storage business following a significant investment in the mature Kinsale Head gas assets and associated infrastructure.

Gas storage is a valuable addition, but important decisions lie ahead

We understand the rationale for gas storage investment. It provides an early mover opportunity to be involved in a gas business that is growing generally but especially in Ireland, where Kinsale is the only operational gas storage available. Moreover, as Providence is a long-term player in the Irish offshore, there should be a significant value-add for all parties.

- The gas storage business is a very different activity from the standard E&P business

However, the gas storage business is a very different activity from the standard E&P business and has different valuation methodologies. As such, we would not be surprised to see a wider separation of the two activities in the future, akin to what other companies have done in the UK.

We believe the group is clearly a better investment opportunity with the gas storage business than without. It provides stability, a core valuation and short-term opportunity unlike the relatively high-risk/high-reward activity of the Atlantic Margin. While the Dunquin and Spanish Point opportunities are being progressed to the drilling stage, gas storage provides an excellent backstop for shareholders.

- Gas storage provides an excellent backstop for shareholders

At the end of 2009, Providence had net debt of circa $125m (including its initial investment in gas storage). When the gas storage is completed, net debt will be c. $160m. While debt stress measures remain comfortable, we think management will try to reduce the overall level of indebtedness as a matter of policy. In addition to internally-generated cash flow, we see asset sales as the most likely way for this to proceed.

Forthcoming events

Investors require activity in E&P stocks. However, major headline drilling projects are unlikely in 2010. Nonetheless, the year will bring a number of important investment decisions, and the timing of the Atlantic Margin plays will also firm up.

The table below demonstrates our best estimates of activity levels over the next two years.

Table 1: Providence activity for 2010 and 2011

2010 activity profile				
Seismic shoot and analysis	**Farm-out**	**Drilling**	**Investment decision**	**Stake**
Spanish Point	Spanish Point			56%
Burren	Burren			56%
Drombeg	Drombeg			16%
	Orpheus			100%
	Pegasus			100%
	Newgrange			16%
		UK onshore		99%
		Gulf of Mexico		Various
			AJE	7%
			SW Expansion	40%
			Ballycotton	40%
2011 activity profile				
Seismic shoot and analysis	**Farm-out**	**Drilling**	**Investment decision**	**Stake**
Burton Down				50%
		Baxter Copse		50%
		Spanish Point		56%
		Dunquin		16%
			Dragon Field	25%

Source: Providence Resources; Davy

Valuation summary

The Providence portfolio is a combination of established oil and gas producing assets, development opportunities and high-impact exploration targets, each with varying degrees of risk and upside.

- **After taking into account debt and decommissioning liabilities of 3.8p per share, we calculate the risked value of Providence at 14.0p per share**

After taking into account debt and decommissioning liabilities of 3.8p per share, we calculate the risked value of Providence at 14.0p per share compared with a current share price of 3.9p.

This valuation is based on discounted cash flow for existing assets and risked EMVs (Expected Monetary Values) for the exploration portfolio. We feel this is the most appropriate way to value the group.

In an E&P stock, investors should seek very high-value leverage. In the case of Providence, the unrisked exploration portfolio alone, assuming complete success, is 83p per share. No exploration programme is ever completely successful, but the upside confirms that there is sufficient compensation for the risk assumed in buying into the exploration programme.

Kinsale Head gas storage assets provide a significant opportunity to grow group's value

The decision to purchase a 40% stake in the Kinsale Head gas storage assets through its special purpose vehicle (SPV), Eirgas, provides a significant opportunity to grow the value of the group.

We see nearly 3p of value per share at the moment without capturing the fuller long-term potential associated with the main Kinsale Field, which is the stated objective of the partners.

- **Our valuation of the Kinsale Head assets assumes that the abandonment provision is deferred until 2020, that SW Kinsale is expanded and that Ballycotton is developed as additional gas storage**

Our valuation is summarised as follows.

- **Our valuation does not assume any extra reserves produced – say by way of a final blow-down of SW Kinsale – or any third party tie-backs through Kinsale Head**

Table 2: Valuation snapshot

	Risked $m	*Risked per share (p)*	*Unrisked per share (p)*
Production	210	4.5	4.6
Appraisal	94	2	5.4
Exploration	376	8.6	82.8
Gas storage			
Current	90	1.9	1.9
Expansion	74	1	1.1
Portfolio value	842	18	95.8
Net debt*	-159	-3.4	-3.4
Decommissioning (discounted value)	-17	-0.4	-0.4
Group value (fully diluted)	669	14.0	86.7

*Assumes final payment of $36m to complete purchase of 40% of Kinsale asset package.
Source: Davy

- **Our valuation inputs are a long-term oil price of $85 per barrel and a US gas price of $5 per MCF. Our $/£ FX is 1.6.**

Gas storage

Providence's introduction to gas storage has its genesis in its long-term holding in the onshore UK Singleton oilfield.

- Petronas is the Malaysian national oil company. It is a fully integrated and diversified oil and gas company. In its last financial year, it had revenues of $77bn and total assets of $200bn.

Having held a 20% interest in the field since 1991, Providence increased its interest to nearly 100% in November 2007 by buying out Star Energy. The buy-out contained an area of mutual interest agreement (AMI) with Star Energy to evaluate gas storage initiatives offshore Ireland, including looking at the possibility of CO_2 sequestration. In early 2008, Star Energy was acquired by Petronas, providing Providence with a new working relationship with that company. This has proved to be very advantageous.

- The group also announced that it had acquired an exploration licence in the Kish Basin, located offshore the east coast of Ireland, with potential for oil and gas exploration as well as potential storage capacity for methane gas and CO_2

The real breakthrough for Providence came with the decision by Marathon Oil to divest some of its non-core global assets, including its Irish portfolio. This presented an ideal opportunity for Petronas and Providence to jointly acquire Marathon's Kinsale Head gas production and storage facility.

- In June 2009, Providence and Petronas signed a three-month option deal whereby Providence, using its 100%-owned SPV, Eirgas, would acquire 40% of Kinsale on the same terms.
- In September, Providence exercised this option.

Originally structured as a 50/50 joint venture (in line with their AMI agreement), Petronas and Providence subsequently amended the deal terms to 60/40 on the back of Petronas fronting the bid and Providence coming in later through an option agreement.

The gas storage model

Gas storage is essentially the inverse of gas production. As a business model, it works for a number of reasons (see side column).

Revenue is produced through a series of charges paid by users of the facility. Such charges, outlined below, are based on the volume of gas units contracted with the storage facility:

- A commodity differential charge (CDC). This is usually the difference between summer and winter prices per unit of gas. A good working number is 15-20p per therm.
- A withdrawal/injection charge. As the name implies, this relates to the cost of injecting gas in and taking gas out of storage.
- A transport differential charge.

Gas storage benefits

- It allows peak demand and supply to be matched
- It provides security of supply in the event of supply disruption
- It has important future applications for use with alternative energy systems
- It should promote a more liquid and visible market in gas trading

Operating costs are generally relatively modest, although there are very high initial set-up costs – including the need to purchase a cushion of gas to provide pressure support for the facility. Cushion gas is usually required to fill about half of the reservoir.

Once the initial capital investment has been made, the business is lucrative if operated properly and offers steady and utility-like returns on investment.

Marathon sale and consideration paid

For the purpose of the sale, Marathon Ireland split its activities into two business units: those offshore the west coast and those in the Celtic Sea. Petronas purchased the package of Celtic Sea assets for sale by Marathon.

- **In April 2009, Petronas closed the deal with Marathon for $180m (with an effective date of 01/01/08)**

The cash consideration for the assets purchased was $180m, with the deal dated to January 2008. In 2008, the Kinsale complex generated revenues of $155m and net profits of $51m. We estimate that available cash flow produced from 2008 and 2009 operations was in the order of $80m. We also estimate that the purchase included a future decommissioning cost of around $150m.

- **At the end of 2007, the Kinsale Head asset package consisted of 3P reserves of 73.6 BCF of gas, 2P of 62 BCF of gas and proven reserves of 46.2 BCF**

Taking into account the implied cash sweep since the deal's effective date (January 2008), we estimate that the final gross cash cost is in the order of $100m. This means that the net cash transaction for Providence is expected to be approximately $40m.

So far, Providence has paid the down-payment of $4m on exercise of the option, with the balance due on closing (which is expected in Q1 2010). Closing is subject only to governmental approval, which is purely procedural.

Assets acquired in Marathon purchase

- Existing gas reserves in Kinsale Head
- Existing reserves in Seven Heads
- Existing SW Kinsale storage
- Ballycotton Field

Assets acquired in the Marathon purchase

The Kinsale Head complex and associated assets consist of the following:

- Existing gas reserves in Kinsale Head
  - At the time of the deal date (January 2008), 3P reserves in the main Kinsale Head were 55.4 BCF based on a 100% stake. Remaining estimated reserves are circa 40 BCF.
- Existing reserves in Seven Heads
  - An 87.5% stake in this field, which at the time of the deal date had remaining 3P reserves of 7.7 BCF.
- Existing SW Kinsale storage
  - This is a working 8 BCF storage facility with a circa 20 BCF gas cushion.
- The Ballycotton Field
  - This is a small, depleted satellite gas field, north of Kinsale Head, which formerly produced around 60 BCF of gas. It has excellent gas storage potential.

- **We value the 40% of the Marathon assets sold and acquired by Eirgas at 4.4p per share**

Valuation summary of 'Kinsale Head complex' assets

Our valuation of the assets purchased by Eirgas is summarised in Table 3. We assume expansion for SW Kinsale and in Ballycotton but no activity related to the main Kinsale reservoirs.

Table 3: Kinsale asset package valuation (before decommissioning costs)			
	Gross $m	*Eirgas (40%) $m*	*Per share (p)*
Kinsale Head gas production	96	38	0.8
Storage			
Existing SW Kinsale	224	90	1.9
Expanded SW Kinsale	103	41	1.0
Ballycotton expansion	81	33	0.7
Totals	504	202	4.4

Source: Davy

This shows a value of over $200m, or just under 4.5p per share, for the storage business and the remaining reserves in Kinsale Head. This is clearly more than the purchase cost to Eirgas of $40m and is made possible through an expansion of the gas storage business.

Base line valuation

- **The baseline valuation does not assume any expansion of SW Kinsale nor any investment in Ballycotton to develop it into a new storage capacity**

We have also looked at a base line valuation (for Eirgas' 40% share) of the assets purchased from Marathon. This valuation assumes the following:

- The main Kinsale Field gas production operations cease in 2014/2015, at which time gas storage operations also terminate.
- Such an action would allow the blow-down of around 20 BCF of gas from SW Kinsale. At 40p per therm, this will produce revenue of £80m (£32m to Eirgas).
- We see the combined value of four years' gas production and storage operations ($50m) and blow-down of SW Kinsale ($35m discounted) broadly matching the consideration of $40m in cash and the present day discounted cost of decommissioning ($45m) – assuming it takes place in four years' time.

Specific asset valuation and review

The specific workings and expansion details of the assets acquired are examined below:

Kinsale Head and Seven Heads

The Kinsale Head field was originally a very large and successful gas field discovered and developed by Marathon. The field has been in operation since 1978 and is currently at the tail end of its life. It has an estimated 40bn cubic feet of remaining gas reserves (this compares with 1.8 TCF of initial gas reserves). Seven Heads is a small sub-structure located to the southwest of the main Kinsale Head field. It contains a small residual amount of gas which is currently being produced.

The remaining reserves in the Kinsale Head field will inevitably decline but will provide revenue over the next four to five years. Not surprisingly, the cost of this gas production is high given that the two platforms were designed to produce up to eight times more than current output levels.

Costs have been minimised by de-manning of platforms and remote monitoring technologies. In addition, Kinsale Head has been supported in recent years as the cost base has been spread over the gas storage and Seven Heads production project.

We value Kinsale Head gas production at around £2m per BCF, based on an average realised price of 50p per therm throughout the year. For valuation purposes, we assume that gas production from the Kinsale facility carries all the costs related to the platforms.

The value of Providence's 40% equity stake on this basis is $38m.

Existing storage

The Kinsale Head Field also includes Ireland's only operating gas storage facility. This has been operating for the last eight years (commercially for the last three) and currently has an 8 BCF capacity.

We value this facility based on an annual margin achieved through buying the gas at summer pricing and selling the gas at higher winter prices. We assume this CPD (Commodity Price Differential) gas margin to be 18p per therm. Other income sources included are an annual storage fee and gas transit charge. Operating costs are assumed to be in the order of 1-2p per therm.

- **Gas storage is well suited to a terminal valuation approach. As the business can be repeated annually, the impact of discounting cash flows eventually becomes immaterial. Assuming a cost of capital and then producing a terminal value for the business provides a sensible alternative.**

We value the business using a terminal value methodology (see across).

Clearly, the lower the hurdle cost of capital assumed, the greater the return – we assume 8%. Utility-type returns could well be lower, which would make the asset more valuable by increasing the terminal value.

We calculate the value of the existing storage business at £56m ($90m), a large figure reflecting the fact that capital has already been sunk.

This equates to a value for working storage of $28m per BCF of gas. This is higher than working gas storage values paid in the UK, with the difference in our opinion accountable because of the lower corporate tax charge in Ireland (12.5%).

Case for expansion of storage business

- **Gas storage plays a key role in securing gas supplies**

EU directive 2004/67/EC provides the overarching legislative framework for securing natural gas supplies. This was placed into Irish law in 2007. The directive included a requirement to ensure supply of gas to domestic and small and medium enterprises during periods of potential shortage.

The original EU directive indicated that gas storage was one of the solutions that should be addressed in ensuring security of supply. It is a reasonable working assumption that this should apply to the Irish market too.

Unfortunately, with only one working facility, Ireland has very limited gas storage availability.

- **According the Commission for Energy Regulation (CER), peak day gas demand is forecast to be 30.5 MCF (million cubic metres) in the 2008/2009 gas year. Total working storage volume for SW Kinsale is 200 MCM with a maximum withdrawal rate of 2.8 MCM.**

SW Kinsale storage, as it is presently constituted, can only meet the following:

- 2.8% of annual gas demand from a 32-county Ireland;
- 14.5% of average day demand and can make this contribution for only 10.4 days;
- 9.2% of peak day demand and can make this contribution for only 6.6 days.

EU pushing for more gas supply security

A recent communication by the EU Commission (July 2009) proposes a repeal of the 2004 directive. In its place, the European Commission intends to put in place a regulation, the most powerful European law-making mechanism available. This regulation will compel governments to ensure gas supplies to cover 60 days of the highest demand experienced during the coldest period (measured statistically as occurring once every 20 years).

- **The Irish market (NI and ROI) consumes just over 7bn cubic metres of gas per year. Over 92% of this gas is imported through the interconnectors – IC1 and IC2.**

Current Irish storage capacity meets 9% of peak day demand (30.5 MCM) for just fewer than seven days.

- **Gas storage in the 32-county Irish market is limited to that available at SW Kinsale**
- **Other potential projects include the use of salt caverns in Larne as storage facilities**
- **These projects are still at the review stage and will not be available until 2014**

Other security of supply projects that are being considered include the proposed LNG facility at Shannon and the use of salt taverns in Larne, NI for gas storage. In theory, both projects have very large maximum withdrawal capacity and both form part of the CER (Commission for Energy Regulation) forecast supply of natural gas to meet future peak day demand. However, even on the most aggressive timelines, the earliest availability would be in the 2013-2014 gas year. In addition, both projects involve a very large capital investment, and neither project has been sanctioned.

Indigenous production also plays a role in security of supply. However, the existing production at Kinsale Head is rapidly coming to an end. The Corrib gas field project is 85% complete and is scheduled to commence production in the next 12 months. This assumes a resolution to various planning issues underway at present. While initial production rates are high (equivalent to one-third of peak day consumption), the field will decline steadily, reducing its 'security of supply role'.

Taken together, there appears to be ample scope for the expansion of existing gas storage facilities at Kinsale.

Expansion of SW Kinsale

The 20 BCF of gas which is still present in the SW Kinsale structure is more than is required to support the existing storage business of 8 BCF. Consequently, it is possible to expand the gas storage capacity by a further 6 BCF of gas. This presents a good investment opportunity.

In total, SW Kinsale would then have 14 BCF of gas storage capability and a 14 BCF cushion (50% storage to cushion ratio).

- **Cushion gas is the gas required to allow a gas storage system to operate. If the expansion takes place, there will be 14 BCF of cushion gas and 14 BCF of storage.**

Not having to purchase cushion gas, drill new wells or install new pipeline capacity ensures a considerable capital saving. We see this project as having considerable value. The principal reason for this is that the presence of existing gas means that no cushion gas has to be purchased to initiate the business. At 50p per therm for example, buying 6 BCF of gas would cost £30m.

We currently value Providence's share of the expansion of SW Kinsale at £29m ($41m), and a decision on expansion is likely to take place this year.

Development of Ballycotton gas storage

The proposed Ballycotton expansion project is a significant step-up in investment and is unlike the SW Kinsale extension. We estimate that up to $600m of capital would be required to buy cushion gas and appropriate infrastructure. The group has already acquired a 3D seismic survey during 2009, highlighting its desire to move forward with this project.

Assuming that the original field held 60 BCF of gas, a gas storage business of up to a total of 35 BCF should be possible.

- **We value Providence's share in the Ballycotton expansion project at £20m ($33m)**

We value Providence's share in the Ballycotton expansion project at £20m ($33m).

Even though this will be a much larger project than an expanded SW Kinsale, the difference in the valuation reflects the fact that it is not yet sanctioned and it has an estimated $600m cost associated with capital required to drill wells, buy cushion gas and build a dedicated line to landfall.

A decision on expansion is likely in 2010.

Financing gas storage

Fortunately, both the utility-type nature of the gas storage and the specific financing capabilities of Petronas mean that any future financing should not be an issue. Such financing will consist of a high proportion of debt with the equity portion supplied from internally-generated cash flow.

In theory, on an 18p per therm differential between winter and summer prices, each BCF of gas should produce revenue of circa $3m on an annual cycle. The predictive nature and low-cost platform make this revenue stream very bankable.

Kinsale Head field potential

This may potentially be the most valuable asset in the gas storage portfolio in the Kinsale Head complex. On the face of it, the sheer scale of the reservoir means that a huge capital commitment would be required to put in place the cushion gas. However, there are a number of discrete sand packages in the main structure that could be developed separately. This makes it more manageable, but the investment in cushion gas is still likely to be substantial.

Interestingly, the scale of the structure is such that CO_2 sequestration could also be considered. A recent report by the Irish and UK governments on the geological storage of carbon in Ireland ranked the Kinsale Head field as the number-one sequestration site with 330m tonnes of capacity.

We have attributed no value to this project for the present.

Exploration

Providence's roots in exploration activities offshore Ireland go back as far as the early 1980s. While the group is probably best known for its work in the Celtic Sea, its focus has shifted in recent years towards the high-impact Atlantic Margin.

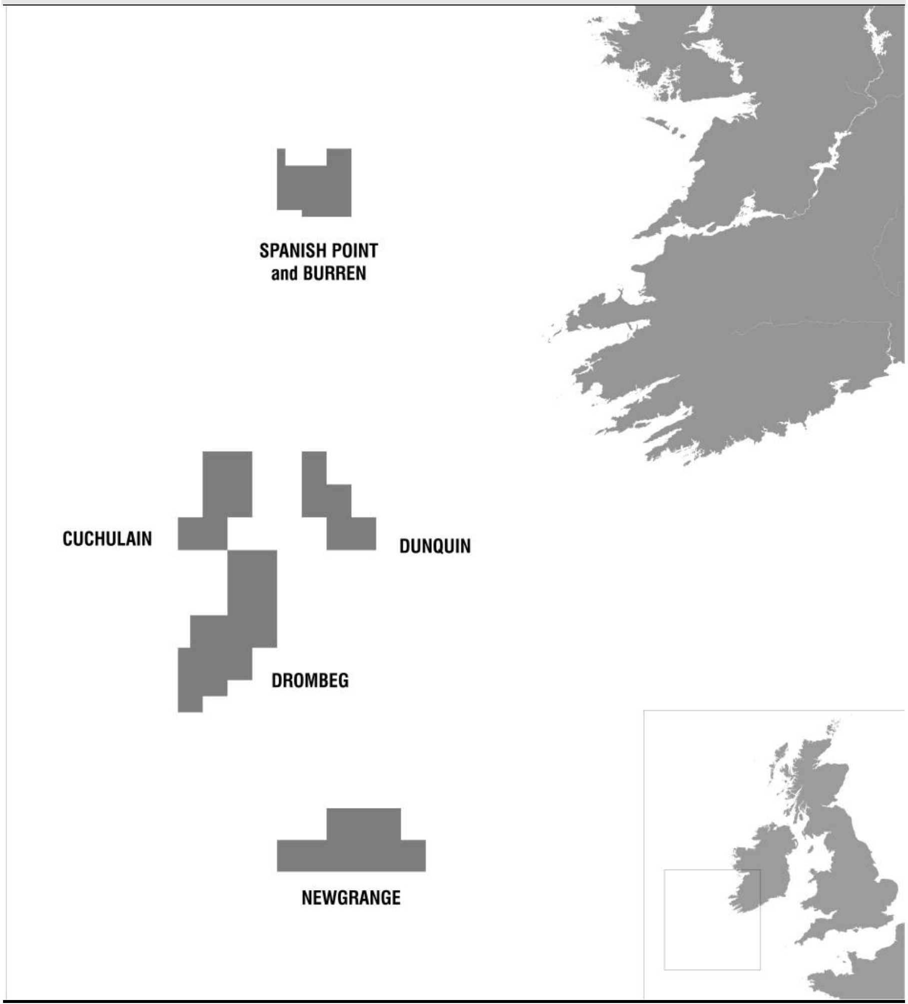
The group's strategy is to use its knowledge base to bring in international companies with balance sheets that can sustain deepwater exploration. In such a scenario, Providence's share would inevitably be diluted; however, the ultimate value is such that even a minor stake will be significant.

Atlantic Margin

- The Atlantic Margin is likely to be the main focus of Providence's exploration activity offshore Ireland in the future

This is likely to be the main focus of Providence's exploration activity offshore Ireland in the future. There are several notable high-impact targets, made up of both exploration and appraisal projects. Providence has established a leading licence position in this area.

Figure 1: Providence's Atlantic Margin licences



Source: Providence Resources

The geology of the deepwater Atlantic Margin is a product of the opening of the Atlantic Ocean during the Mesozoic era. Several basins and related sub-basins were formed along this 'passive' margin.

Providence has acreage in the Porcupine area and further to the south in the Goban Spur.

The Porcupine Basin has a number of discoveries which established that it contains several valid working petroleum systems, each of which has source, reservoir and seal characteristics. Further to the south, the Goban Spur area has several very large targets which have been mapped using seismic data.

The nearest analogy to the southern part of the Porcupine Basin and the Goban Spur basins is the Jean D'Arc and Orphan Basins offshore Newfoundland, of which the former hosts fields such as the giant Exxon Mobil-operated Hibernia field.

Dunquin – The Exxon Mobil factor

- Having acquired the Dunquin licence acreage in 2004, the company developed a new geological model for the region and subsequently set about marketing the project to industry players

The arrival of Exxon Mobil (which farmed into the Dunquin licence in 2006) was seen as validating the group's geological interpretation of the Southern Porcupine.

New seismic was acquired, and in 2008 Exxon Mobil assumed operatorship. Exxon Mobil has also undertaken a large amount of additional technical work in the region, much of which is beyond the financial and technical resources of the smaller partners.

Exxon Mobil is now also the operator of FEL (Frontier Exploration Licence) 1/08 and 2/08.

The presence and commitment of Exxon Mobil should be seen as a significant validation for partners in the group. In addition, it shows that although the region and target profile is still high risk, the scale of the targets justifies the risk-reward profile.

The interest of major oil and gas companies in the sector was confirmed by the recent farm-out of a 40% stake in the Dunquin licence to ENI.

The Dunquin Prospect

- A new play is developing in the Southern Porcupine and Goban Spur. This (new play or theory) suggests that rather than the clastic or sand-based reservoirs in other Irish offshore areas, the target is large carbonate features. This type of reservoir is well known in the Middle East and in the Gulf of Mexico and can host very large quantities of oil.

The Dunquin Prospect is interpreted as a very large Lower Cretaceous carbonate platform system sitting on top of the Porcupine Median Volcanic Ridge. The seismic, which has been used in the mapping of the Dunquin Prospect, also reveals the presence of several DHIs (direct hydrocarbon indicators).

If the prospect, which is split into north and south targets, is filled with hydrocarbons, the upside is 19 TCF (equivalent to 3bn barrels of oil equivalent). The P50 or median case is 9 TCF (equivalent to over 1.5bn barrels of oil equivalent).

- Reconstruction of the paleogeography and analysis of plate tectonic supports this new play
- The potential for very large scale explains the presence of Exxon Mobil and ENI

The working assumption for now is gas, but it may well be condensate or black oil.

The licence is operated by Exxon Mobil which, on behalf of the consortium, has elected to enter phase 2 of the licence. This phase includes a firm well commitment within the next two years. We estimate that such a well could cost up to $150m.

- Providence holds a 16% share in the Dunquin licence. The entry of Exxon Mobil meant that this stake is substantially carried. Although the details have never been published, the value of the carry is likely to have included the equivalent of the cost of at least one well and possibly two.

The question as to whether the structure has porosity (spaces that could contain hydrocarbons) or whether it is a massive crystalline tight structure can only be definitively answered by drilling a well.

The positive outcome is based on a view which suggests that Dunquin is a large Lower Cretaceous carbonate feature similar to giant fields in the Middle East and the Gulf of Mexico.

Our risked valuation of Providence's share in Dunquin is 2.1p per share. However, the value upside is very large with a success case outcome worth in excess of 20p per share.

Spanish Point

- Unfortunately, the well bore was damaged prior to testing and so the consortium mobilised a fracture stimulation vessel which, due to inclement weather, was unable to carry out operations that would have demonstrated the well's full productivity

The Spanish Point structure was first drilled by a consortium led by Phillips Petroleum in 1981. The discovery, well 35/8-2, logged four hydrocarbon-bearing Upper Jurassic sandstone intervals over a gross 1,400-feet hydrocarbon interval. One of these four zones was subsequently tested and flowed at 925 barrels of oil per day and 4.9m cubic feet of gas.

No follow-on was undertaken by Philips given the distant offshore location of the discovery and the value of oil and gas at that time.

In 2004, at the same time that Providence licensed Dunquin, it acquired the licence over Spanish Point/Burren. A P50 estimate of resources was carried out, indicating that the structure could contain c.1.4 TCF of gas and 160m barrels of oil recoverable.

- Chrysaor has the option to increase its interest to a maximum of 70% through paying for the cost of not less than 60% of two wells

In 2008, Chrysaor farmed into the licence in return for committing to the cost of a 3D seismic survey and the potential drilling of up to two wells. Providence now has a 56% stake in Spanish Point; however, if Chrysaor elected to drill two wells, its stake would drop to around 32%. The recently-completed, Chrysaor-funded 3D seismic survey over both Spanish Point and Burren confirmed earlier expectations and was helpful in setting out the structural context and architecture of each discovery.

- Providence carried out a number of development studies and concluded that a conceptual development utilising fracture stimulated wells and a TLP (tension leg platform) was the leading candidate. The key remaining issue is well productivity, which can only be determined by drilling an additional well.

At Spanish Point, the preliminary data show significant structure up-dip from the discovery well as well as minimal faulting.

At Burren, which previously had only 2D data, the 3D has allowed the consortium to see significant reservoir (sand thickening) which it had previously not seen. This suggests good volume upside in the Burren target.

Burren

The Burren discovery well was drilled in 1978. It tested 733 barrels per day of good quality oil from Lower Cretaceous sands and lies close to the Spanish Point gas condensate field.

Similar-aged reservoir zones are oil bearing within the giant Exxon Mobil-operated Hibernia field, offshore Newfoundland. Following the recent 3D seismic programme, there looks to be significant reserve potential. We value Spanish Point at 4.3p per share risked with no value yet attributable to Burren (until the group provides more data).

Other frontier licences

Providence holds a number of frontier licences that have been acquired in recent years. Exxon Mobil operates the Drombeg blocks which are located to the southwest of the Dunquin prospect and which were the subject of a recent long offset 2D seismic survey.

Also to the south, the Newgrange Licence option has had both new seismic shot and older seismic reprocessed. A very large four-way dip closed structure has been mapped with potential for up to 10 TCF of gas. Providence is the operator of this licence option.

While the Newgrange and Drombeg prospects are a crucial part of the exercise to build up a dominant position in the carbonate play along the Atlantic Margin, our value modelling places high risk factors on these prospects. For now, we value these licences at only 0.3p per share.

Celtic Sea and St George's Channel Basins

The Celtic Sea/St George's Channel Basins, which are very well known to Providence, contain a number of legacy discoveries and prospects. So far, efforts to convert these to commercial projects have failed largely because follow-up drilling has not delivered on the initial promise either due to structural complexity or to the high viscosity of the oil discovered. Unfortunately, this has been a recurring theme of the Celtic Sea and is a major factor in the group's decision not to aggressively pursue further exploration in this area.

- **We do not think Providence will pursue traditional-style oil and gas plays in the Celtic Sea, but it does retain a material equity position in a number of former discoveries**

Because of this inability to commercialise any of the early discoveries, despite several attempts, we do not think Providence will pursue traditional-style oil and gas plays in the Celtic Sea. Nevertheless, Providence retains a material equity position in a number of former discoveries. It recently announced that it put these assets into a SPV called Exola that will focus on unconventional oil plays in the region using its high equity stake and tax losses to attract joint venture partners.

In addition, it is possible that at some stage in the future infrastructure will be developed to reduce the upfront risk of bringing these discoveries on-stream. Any development of gas projects would be done in conjunction with Eirgas using the Kinsale Head infrastructure.

In the St George's Channel, Providence has a 25% interest in the Dragon gas field, which sits on the median line between UK and Ireland in the north Celtic Sea. The discovery well was drilled in 1994 by Marathon where it flow tested at 21 MMSCFGD and 120 BOPD. Its recoverable reserves are estimated at 70 BCF. The group is currently evaluating gas development and gas storage opportunities.

Our valuation of the Celtic Sea and the St. George's Channel licence and prospects is 2p per share in total.

Nigeria – AJE field has significant strategic importance

While Providence's 6.7% equity interest in the AJE field offshore Nigeria is small, we believe that it has significant strategic importance. The field is located offshore western Nigeria and is at the eastern extremity of the West African Transform Margin (WATM) play.

A proven oil and gas discovery, with four wells drilled to date, it is estimated to contain over 285 MMBOE recoverable. This field is now at pre-FEED (Front End Engineering and Design) stage, with a partnership comprising Chevron, VITOL, EER and the local indigenous partner and operator, YFP. A FID (Final investment decision) for the project is expected in 2010.

- AJE is a useful window into the eastern end of the WATM play

We see this stake in AJE as a useful window into the eastern end of the WATM play which may attract an interested party at the right bid.
We currently value Nigeria at 0.7p per share risked.

Production and reserves

- **Production at the end of 2009 is expected to have been in the order of 4,000 barrels of oil equivalent per day (BOEPD); Providence plans to grow this to 5,000 BOEPD per day by the end of 2010.**

Providence produces oil and gas from the Gulf of Mexico, onshore UK and offshore Ireland. If we assume a consolidation of the Eirgas purchase, production at the end of 2009 is expected to have been in the order of 4,000 barrels of oil equivalent per day (BOEPD). Providence plans to grow this to 5,000 BOEPD per day by end-2010.

An additional 10,000 barrels per day of production is possible by the middle of the decade, although this will require development of the AJE field offshore Nigeria, further growth in the Gulf of Mexico and the development of the Dragon gas field, offshore Ireland/UK.

Table 4: Current and forecast production growth profile (m boe)

	2008	*2009*	*2010*	*2011*	*2012*	*2013*
Singleton	0.18	0.22	0.31	0.40	0.51	0.55
GOM	0.49	0.7	0.8	1.0	1.2	1.3
Kinsale*	0	0.37	0.548	0.411	0.308	0.231
Total	0.68	1.28	1.68	1.82	2.01	2.06
BOPD	1,850	3,509	4,600	4,975	5,494	5,633

*assumes purchase of Eirgas for 2009 estimate
Source: Davy; Providence Resources

US – plans to increase production

- **In 2008, Providence acquired nine producing fields, two development assets and a package of exploration assets for a consideration of $67.5m**

Providence has had a presence in the Gulf of Mexico since early 2007, but its interests were substantially increased through the purchase of the Triangle assets in June 2008 (see side column). The group plans to increase its US production to 3,500 barrels of oil per day by 2012.

Growth in US production depends on investment levels in the US business and prevailing gas prices.

Table 5: Group reserve profile (MMBOE)

	Proven	*3P*
UK	4.9	9.9
USA	5.4	11.3
Ireland	2.0	
Totals	12.3	21.2

Source: Providence Resources

UK – plans to increase recovery

- **Providence increased its interest in the Singleton field to 99.125% in 2007 for $15.5m**

In the UK, the group produces from the Singleton oilfield in which it now has a 99% share. Production growth depends on the level of investment in new wells. The initial target is to increase output to over 1,000 barrels per day in 2010, growing to 1,500 barrels per day by 2012.

Singleton has a large amount of oil in place for an onshore UK field (107m barrels), but recovery factors have been historically low (only

- **Singleton presently flares around 200 BOEPD. Planning is underway to convert this gas to power (gas to wire) and export to the National grid.**

3.5% recovered to date). Providence plans to increase recovery to 10% using modern oil field techniques including well stimulation, fracture stimulation and additional horizontal production wells.

In the longer term, there are possibilities to expand production further by accessing the existing Baxter's Copse field and drilling the Burton Down prospect.

Ireland

Kinsale Head gas production, in which Providence has a 40% share, is currently producing 5,000 BOEPD. Due to the mature nature of the field, this is expected to decline by around 25% per annum with the field ceasing production in 2015.

Financials and forecasts

Financial performance – debt manageable, but management likely to rebalance debt equity ratio over time

Providence has net debt of $125m. This consists of $64m senior debt (out of a recently arranged $100m BNP Paribas facility). The balance of the facility ($35m) is available to finance the proposed completion of Kinsale. The company also has a €42m convertible bond (maturity in June 2012 with an annual coupon of 12%).

Debt stress tests show that on the projected revenue base, this debt is manageable with net debt to EBITDA steadily improving. Even though the charge on the convertible bond is expensive at 12%, our estimates also show that sufficient cash is generated to comfortably manage interest payments (interest is covered 1.6x in 2009 and 2.6x in 2010),

We suspect that the group will look to rebalance the debt equity ratio over time, and we see the recent change to BNP Paribas as part of this exercise.

Providence has a number of successful hedges in place which provide support to its revenue and cash flow profile.

Forecasts

We do not think that the group's financial performance at this stage of its development has a particularly large bearing on its overall value, other than to give confidence that there is a core of growing cash flow generation to meet its annual cost base and that it can comfortably meet its financial liabilities.

Table 6: Forecast snapshot ($m)

	2009	*2010*	*2011*	*2012*	*2013*
Revenue	29	87.1	110.2	129.6	132.4
EBITDA	12.5	55.3	77.5	95.7	99.2
EBIT	(3.3)	35.3	63.3	88.1	91.2
Interest	10	12.9	12.6	12.2	11.4
Pre-tax	(13.3)	22.4	50.7	75.9	79.8
Net income	(14.7)	11.7	29.1	45.6	47.3
Cash flow	1.1	51.8	57.4	60.8	63.1
Net debt	125	169	164	158	145
Net debt/EBITDA	4.8	3.0	2.1	1.6	1.5
Interest cover (PBIT/Interest)	1.6	2.6			

Source: Davy

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