

Armour Energy Limited

Kincora works begin...equity raise expanded

Armour Energy Limited (AJQ.ASX) is a junior energy producer and explorer with assets across northern, southern and eastern Australia. The company has been listed on the ASX since April 2012. The opportunity set for Armour through FY21 has the capacity to materially reshape the company financially by delivering cash flow growth, reducing debt and progressing a range of exploration options. Although significant exploration drilling may not occur until the end of CY21 and into 2022, the company is likely to be in a stronger position to work its assets at its own pace and to its own plan. We will be looking for delivery of the Kincora production growth plan which aims to more than double production, to 20TJd and growing over the next 18-24 months.

Business model

Armour Energy is a junior oil and gas company holding a production base with expansion options; and an extensive exploration portfolio across three Australian states, dominantly focussed on exploring for gas. The portfolio consists of exploration plays, reflecting a mix of moderate risk and early exploration stage with transformational potential. The company is looking to leverage its production growth plan at Kincora to repair its balance sheet and service a more aggressive exploration strategy, without recourse to equity markets. Financing is always a concern at the small end and the company's high working interests provide options through partnering.

Progress at Kincora...more money in the bank

The production enhancement programmes at Kincora have commenced, which will provide data for benchmarking against the growth plan. The first three wells to be fracked should be completed and on-line by end-2020...we will know quite quickly how deliverable the growth targets and strategy will be. It is an iterative process with results from each frack process used to tweak the remaining wells. Success could see AJQ move a long way towards its target of up to 20TJd by end-FY21.

The capital raise announced on 15-June has been upscaled to \$15mn (from \$10mn) as evidenced of stronger market confidence and demand. AJQ will now be able to firm additional activity in the Cooper Basin and on the Newstead Gas Storage asset. The Newstead play in particular can provide annuity style cash flows and the business case for AJQ is enhanced with expansion, particularly as an adjunct for export operators...the recent Federal Government energy initiatives including expansion of the Wallumbilla hub, make Newstead a valuable and strategic asset.

Valuation – no material change

Valuing early phase exploration and even production growth assets is a subjective exercise. We base our indicative valuation on risk-weighted development scenarios and typical unit NPV values across a range of prices and resource outcomes. Where appropriate we apply discretionary probability weightings to pricing, volume and success factors, which we believe are reasonable given the commercial operating environment and available data.

On a larger capital raising (with resultant higher issued shares dilution), roll forward of asset values and net debt adjustment, we have made minor adjustments to our NAV. We assign a risked valuation of \$118m (13cps) to AJQ. **The reference share price (2.2cps) would suggest the market is heavily discounting the production growth and transformational gas opportunities, likely on financing and corporate risks which should be somewhat alleviated in the short term.** The company has a number of deliverable outcomes, particularly pertaining to Kincora production expansion that have the potential to re-rate market sentiment and crystallise asset values as ascribed.

Energy exploration & production

25 September 2020

Share details

ASX Code	AJQ
Share price (date)	\$0.022
Market Capitalisation	\$20.5M
Shares on issue (as at 18-Sep)	930M
Cash (as at 30-June)	\$3.2M
Free Float	~69%

Share performance (12 months)



Upside Case

- Above expectation results from Kincora gas growth programme...more gas, higher price, lower capex
- Northern Australia success...progress at Egilabria and securing a farm-in partner for the NT assets. Referred success from regional exploration would crystallise value
- Success opens alternate financing options, improves the balance sheet and restricts dilution

Downside Case

- Gas growth is not delivered to expectation
- Current operating environment persists and all projects slow down
- Senior Secure Amortising Notes covenants require additional equity capital or asset divestment

Board of Directors

Nick Mather	Executive Chairman
Stephen Bizzell	Non-Executive Director
Roland Sleeman	Non-Executive Director
Eytan Uliel	Non-Executive Director

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Surat (Kincora) work programme commences...on the cusp of tangible growth

It's worth referring to our Scoping Report ("Setting the scene for growth" 4-Sep) for a more detailed review of the Kincora Project, the growth (expansion) plans and potential financial impact.

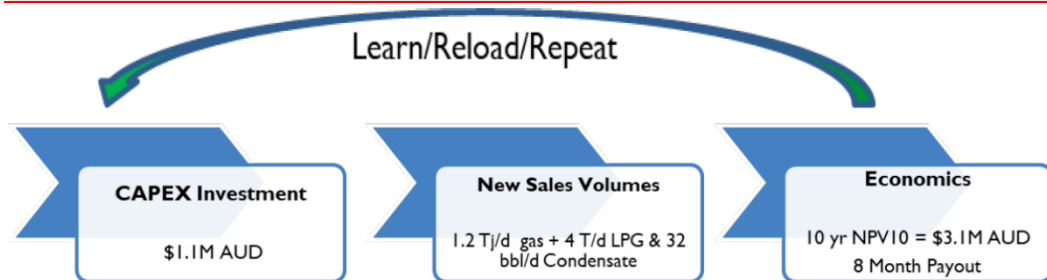
The first step in addressing the intrinsic growth potential is underway with the commencement of the 2020 field campaign consisting of the stimulation and completion of three wells in the field (Horseshoe-4, -5 and Warroon-1).

The company will frack and stimulate a further three wells through 1H21 and undertake additional production enhancements including the installation of pumps and assisted lift in another four wells. It will become evident quite quickly as to how achievable the first part of the Phase 4 expansion plan is...increasing gas output to 20TJd.

The current gas production rate of <10TJd is constrained by well deliverability which is the first bottle neck to be addressed through the stimulation and artificial lift campaign.

Interestingly, AJQ has released an indicative estimate of the Horseshoe-4 economics, importantly adding an estimated 1.2TJd, 4tpd of LPG and 32bpd of condensate.

Exhibit 1: What success at Horseshoe-4 could deliver



Source: Company data

Whilst the actual performance may deviate from these estimates, if Horseshoe-4 can be deemed to be representative of the success case, we can broadly extrapolate the output to the remaining workovers in the campaign to imply, increased production potential of perhaps 7-7.5TJd, 25tpd (LPG) and 190bpd (condensate).

In aggregate with the last reported (quarterly) production numbers, the field could be delivering gas output around 15TJd with some 40tpd (LPG) and some 350bpd (oil and condensate)...a significant step towards the initial target of 20TJd (increasing to 30TJd) with upside from artificial lift projects.

These extrapolations should be considered speculative at this stage, however, with the first three, well stimulations expected to be completed and delivering sales gas before end-2020, we will have direct benchmarking data to hand quite quickly.

The company has identified some thirteen stimulation projects inclusive of the current six well campaign *"...targeting by-passed or untapped gas zones previously deemed as too tight or unproductive...this is the relatively easy 'low hanging fruit'"*.

Source: [Setting the scene for growth](#), RaaS Scoping Report: 4-Sep

It is worth highlighting again, commentary from a recent company presentation indicating the critical focus of the frack stimulation programme is the Black Alley shale and sands, which have been deemed prospective in more than 10 wells in the field. The Black Alley Shale is an important regional seal and source rock and contains intra-formational sands which could be quite an attractive exploration target.

A very successful capital raising programme underpins confidence in the growth opportunities.

On 15-June, 2020, the company entered into a series of share placements and an underwritten Accelerated Non-renounceable Entitlement Offer to raise ~\$10mn. As a result of strong demand this raising has been increased to \$15mn, subject to the requisite shareholder approvals, which will be sought at the company's AGM in November.

Importantly DGR Global Ltd, the company's largest shareholder has indicated its support and intent to maintain its current percentage holding at ~19%, subject to the requisite approvals.

Adding some \$5mn to the cash base provides the company with the capacity to accelerate field programmes that may have previously been subject to funding.

In addition to the current Surat (Kincora) production growth activity, AJQ will prioritise:

- **Cooper Basin exploration**, specifically high-grading the leads and prospects portfolio to generate 3-5 'ready to drill' targets by the end of FY21. Whilst this has always been the aim, additional capital would have been likely required on our modelling, which is now covered by the increase in funds raised.
- **A Newstead Gas storage restart**. Gas storage is valuable and we suggest will become increasingly so as the east coast gas story continues to evolve. Newstead, as a mechanism to smooth supply, optimise field production and arbitrage gas prices and connected directly into the Wallumbilla hub makes AJQ a unique proposition with respect to the alternative upstream operators.
The company plans to complete "...minor above ground facility works to restart the project including overhaul of the sales gas injection compression equipment and installation of a new bi-directional valves at the pipeline interconnection facilities in the Wallumbilla Gas Hub."

Source: ASX release 18-Sep

Recent federal government initiatives and plans to increase Wallumbilla capacity and connect into a number of new basins, makes a storage facility, even if considered small in absolute terms, quite strategic, although expansion to 24PJ is not an inconsequential volume.

Production growth and an 'annuity style' infra-play provide a strong points of differentiation from an investment perspective.

Tweaking the valuation

We value AJQ using estimated unit values on reserves and; contingent and prospective resources adjusted for discretionary probability weightings (1-risk %), to derive a gross portfolio worth. Probability weightings are subject to change as the company delivers the next phase of exploration results and operating conditions.

Where possible we model development outcomes based on broad guidance and historical outcomes but note these are adjusted and overlain by the RaaS risk outlook reflecting our views of the technical and commercial uncertainties associated with delivering the projects as modelled.

The current work programmes associated with Kincora have the capacity to materially alter our project assumptions and weightings over the next 9 months or so.

We note that beyond Kincora, most of the remaining portfolio is early stage exploration and ascribed values are subject to potentially significant change related to drilling results – both direct and indirect.

We have made minor adjustments to our NAV based on:

- In line with the Corporate Bond facility amortisation schedule (29-Sep) we have reduced our net debt estimate marginally to \$52mn;
- On a larger capital raise we lift the issued capital to 930mn shares.

In absolute terms our A\$m value of the portfolio increases slightly to \$118mn (from \$114mn), offsetting the share dilution, such that our NAV remains at \$0.13/share.

Exhibit 2: AJQ NAV – the share price continues to reflect an overly risked outlook

				Pr	A\$m	A\$/share	
Queensland							
Kincora	Various	100%	50%	\$74	\$0.08	RaaS development scenario on 2P volumes	
Newstead storage		100%	50%	\$13	\$0.01	With 'risked' expansion	
Exploration	Various	100%		\$10	\$0.01	Includes conventional and unconventional opportunities...nominal only	
Northern Australia							
Isa Super Basin	Various	30%	25%	\$16	\$0.02	Using the lower of risked weighted Prospective Resources or carry of STO farm-in deal	
MacArthur Basin	Various	100%	1%	\$35	\$0.04	Using risk weighted 2C and Low Case Prospective Resources	
Cooper Basin							
Exploration	Various	100%		\$10	\$0.01	Nominal only	
Victoria							
Wombat-Trifon	PRL 2	15%	25%	\$10	\$0.01	Based on a risk weighted development model and ascribed 2C volumes	
Otway-1	PEP 169	51%	6%	\$3	<\$0.01	Drill-ready opportunity with low economic threshold...likely to be small (but potentially profitable)	
Other					\$3	<\$0.01	Includes a 6.12% LKO shareholding
					\$174	\$0.20	
Net debt (as at 30-Jun)					(\$52)	(\$0.06)	
Corporate					(\$5)	(\$0.01)	
TOTAL					\$118	\$0.13	
Shares issued (mn)*		930					

Source: RaaS analysis; Risked values based on look through Probabilities of Success (POS) for drilling and weighted by a RaaS risk overlay. Weightings at RaaS discretion.

Exhibit 5: Financial Summary

ARMOUR ENERGY LTD			AJQ	
YEAR END		June		
NAV	A\$cps	\$0.13		
SHARE PRICE	Acps	\$0.022		
MARKET CAP	A\$m	20.5		
ORDINARY SHARES	M	930		
OPTIONS	M			

nm = not meaningful
na = not applicable

As per ASX data 18-Sep

COMMODITY ASSUMPTIONS		FY19A	FY20E	FY21E	FY22E
Realised liquids price	US\$/b	96.03	66.26	60.73	64.13
Realised gas price	US\$/mcf	6.06	5.76	5.28	5.57
Realised LPG Price	A\$/t	581	484	443	468
Exchange Rate	A\$:US\$	0.7157	0.6822	0.6899	0.6886

PRODUCTION		FY19A	FY20E	FY21E	FY22E
Condensate/Crude Oil	kboe	56.2	55.2	118.1	156.9
Nat Gas	PJ	3.3	2.7	5.9	10.1
LPG	kt	4.5	4.2	8.8	21.0
TOTAL	kboe	627	527	1,148	1,975

RATIO ANALYSIS		FY19A	FY20E	FY21E	FY22E
Shares Outstanding	M	509	779	930	930
EPS (pre sig items)	Acps	(2.4)	(1.5)	0.7	2.3
EPS (post sig items)	Acps				
PER (pre sig items)	x	na	na	3.3x	0.9x
OCFPS	Acps	(1.9)	(10.3)	(0.5)	37.2
CFR	x	na	na	-4.9x	0.1x
DPS	Acps				
Dividend Yield	%				
BVPS	Acps	87.9	59.2	54.2	78.1
Price/Book	x	nm	nm	nm	nm
ROE	%	(29%)	(21%)	11%	28%
ROA	%	(11%)	(8%)	5%	17%
(Trailing) Debt/Cash	x		18.1x	41.1x	16.4x
Interest Cover	x		nm	3.0x	11.2x
Gross Profit/share	Acps		8.1	16.3	45.0
EBITDAX	A\$m	10.0	10.4	21.9	43.8
EBITDAX Ratio	%				

EARNINGS	A\$000s	FY19A	FY20E	FY21E	FY22E
Revenue		27,819	23,208	39,123	72,295
Cost of sales		(19,018)	(16,931)	(23,978)	(30,507)
Gross Profit		8,801	6,277	15,145	41,788
Other revenue		78	2,879	5,000	0
Other income		193	123	69	44
Exploration written off		0	(520)	0	0
Finance costs		(13,656)	(5,276)	(3,357)	(3,042)
Impairment		(71)	0	0	0
Other expenses		(19,990)	(15,810)	(8,577)	(10,732)
EBIT		2,467	(4,257)	9,925	34,098
Profit before tax		(10,996)	(9,410)	6,637	31,100
Taxes		(688)	(403)	(597)	(9,330)
NPAT Reported		(11,684)	(9,812)	6,040	21,770
Underlying Adjustments					

NPAT Underlying	A\$000s	FY19A	FY20E	FY21E	FY22E
CASHFLOW					
Operational Cash Flow		1,436	11,223	24,629	62,073
Net Interest		204	(5,153)	(3,896)	(3,150)
Taxes Paid		0	0	0	0
Other		(2,219)	(24,375)	(28,945)	(30,631)
Net Operating Cashflow		(987)	(7,999)	(420)	34,592
Exploration		(169)	(529)	0	0
PP&E		(22)	0	0	0
Petroleum Assets		(16,714)	(16,686)	(10,200)	(22,500)
Net Asset Sales/other		3,217	17,842	14,000	5,000
Net Investing Cashflow		(13,688)	628	3,800	(17,500)
Dividends Paid					
Net Debt Drawdown		11,612	(6,066)	(11,350)	(15,559)
Equity Issues/(Buyback)		7,184	7,457	6,234	0
Other					
Net Financing Cashflow		18,796	1,391	(5,116)	(15,559)
Net Change in Cash		4,121	(5,980)	(1,736)	1,533
BALANCE SHEET					
Cash & Equivalents		9,225	3,245	1,508	3,042
PP&E & Development		42,382	61,107	69,531	75,986
Exploration		49,277	33,824	33,824	33,824
Total Assets		116,552	124,446	118,626	129,582
Debt		58,618	61,975	49,753	33,381
Total Liabilities		71,793	78,308	68,258	57,005
Total Net Assets/Equity		44,759	46,138	50,368	72,577
Net Cash/(Debt)		(49,393)	(58,730)	(48,244)	(30,340)
Gearing dn/(dn+e)		52%	56%	49%	29%

Net To AJQ		1P	2P	3P	Contingent 1C	2C
Kincora Reserves						
Sales Gas	PJ	67.4	150.3	321.1		
LPG	kt	139	310	663		
Condensate	kb	670	1,493	3,191		
Oil	kb	246	1,221	2,640		
Isa Super Basin (STO farm-in area)						
Sales Gas	PJ				10.3	48.1
MacArthur Basin plays						
Conventional	PJ				2.5	6.2
Wombat-Triton						
Sales Gas	PJ				437	818
Otway-1						
Sales Gas	PJ					35
Prospective Resources		1U	2U	3U		
Isa Super Basin (STO farm-in area)						
Sales Gas	PJ	2,079	6,881	18,399		
MacArthur Basin plays						
Conventional	PJ	1,351	4,990	31,081		
Unconventional	PJ	3,950	31,185	345,634		
TOTAL	PJ	5,301	36,175	376,715		

EQUITY VALUATION		Interest	Pr	A\$m	A\$/share
Queensland					
Kincora		Various	50%	\$74	\$0.08
Exploration		Various		\$10	\$0.01
Newstead Gas Storage			50%	\$13	\$0.01
Northern Australia					
Isa Super basin		Various	25%	\$16	\$0.02
McArthur Basin		Various	1%	\$35	\$0.04
Cooper Basin					
Exploration		Various		\$10	\$0.01
Victoria					
Wombat - Trifon		PRL 2	25%	\$10	\$0.01
Otway-1		PEP 169	6%	\$3	\$0.00
Other				\$3	\$0.00
Net cash/(debt)					(\$52) (\$0.06)
Corporate costs					(\$5) (\$0.01)
TOTAL				\$118	\$0.13

Source: RaaS Advisory, Company data



FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

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Corporate Authorised Representative, number 1248415

of

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AFSL 456663

Effective Date: 26th November 2018

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- our services
- how we transact with you
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Website: www.afca.org.au; Email: info@afca.org.au; Telephone: 1800931678 (free call)

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