

22 January 2024

State Gas

Final construction stage with commissioning imminent

State Gas Limited (ASX:GAS) is a junior energy producer and explorer with assets concentrated in the Bowen Basin, Queensland. The Rolleston West CNG Project in the Bowen Basin is now in the final stage with mechanical completion and tie-in of the Rougemont-2/3 well anticipated within the next week to be followed by pre-commissioning activities. Importantly, first production and shipments are tantalisingly close and whilst the rate will initially be modest, up to 0.75TJd, the project has intrinsic growth potential (up to 1.7TJd) which could fund modest appraisal and evaluation works, particularly converting contingent gas to bankable reserves. We highlight that the company has invested in weather-proofing the access road and facilities pad providing continuous access and production utility for the project. First gas is always a critical event driver in demonstrating the commercial potential of the assets and providing a cash-flow platform to support growth strategies. Although not noted in the update, we understand the company intends to return to drilling in 2024 to provide additional production capacity to boost RW-CNG output. It is worth noting that whilst industry macro-drivers highlight a continuing gas supply squeeze and rising prices, progress on new developments has been frustratingly slow. In this regard GAS will have stolen a first-mover advantage in the transition from explorer to producer – cash flow is cash flow and initial production can be considered as a quasi-commissioning blueprint for next-phase and scale-up opportunities. The company's assets are ideally located within a transmission pipeline network with adjacent production analogues translating to relatively low operating and commercial risk. The company holds a material net 2C contingent resource base of more than 500PJ and the strategy to convert resources into reserves and build production at scale is now firmly under way.

Business model

State Gas is a junior gas company holding a suite of assets containing a significant 2C contingent resource base with a small-scale, initial production project set to commence imminently. The resource lies in the gas-prolific Bowen Basin with accompanying infrastructure and production analogues. In the gas business, resources can be converted to reserves rapidly with continuing strong demand from buyers and we believe, a recent east coast supply sales contract set at a premium to the benchmark price for pipeline gas in Queensland. We suggest there are material expansion opportunities in the GAS portfolio with transformational potential. Project start-up is materially important in demonstrating the commercial potential of the play and generating cash flow. Beneficially, State Gas holds its critical licences at 100% providing future financing optionality through partnering. The company's resource base and high working interests provide opportunity and leverage but progress is more likely to continue to be capital rather than opportunity constrained in the short-term.

Rolleston West CNG start-up is close

We have previously asked...are we there yet? Well yes, first gas is just around the bend. Rolleston West production can underpin a declaration of initial 2P reserves and support expansion and growth financing options. Critically, the company is on the cusp of first gas when progress on peer group projects has been somewhat glacial. Although modest, the Rolleston-West project can be considered as quasi-commissioning for future, larger-scale opportunities, refining the well design and production-type curves. Demonstration of commercial viability flows through to the portfolio with de-risking and re-rating potential. Importantly, GAS is working its asset base and in doing so perhaps can attract corporate interest...M&A activity often focuses on companies with 'lower-risk' growth options. The path to scale and growth begins with the first PJ.

Riskd valuation of \$204m (\$0.74/share)

Our valuation for GAS stands at \$204mn (\$0.74/share) noting the potential for unwinding risk overlays as the CSG project ramps up, against a reference price of \$0.165/share. Our value of the gas resource remains unchanged but we caution the current critical risk factor is the prevailing gas price, particularly in the spot market. Valuing assets in a pre-evaluation, pre-development phase is somewhat subjective considering financing, timing, and development model uncertainties. The resource opportunity for GAS is transformational and at 535PJ (2C), we believe could be deliverable in an optimal timeframe. The commencement of production at the Rolleston West-CNG Project should begin to close the value gap. Further in-field activity to better define a greater economic case and convert resources into reserves can de-risk the entire portfolio. The time has never been better to progress and deliver gas projects, there is a material and growing commercial opportunity to capture.

Share Details

ASX code	GAS
Share price (19-Jan)	\$0.165
Market capitalisation	\$45.4M
Shares on issue	274.2M
Est. net cash	\$3.0M
Free float	~56%

Share Price Performance (12 months)



Upside Case

- Rapid progress to the limit of the CNG option – 1.7TJd into spot gas sales can deliver material revenue
- Upside to realised spot gas prices
- Accelerating gas commercialisation across the portfolio...the supply squeeze is getting tighter and the opportunity is now

Downside Case

- Unexpected issues arise through the commissioning phase or in well deliverability
- Lower-than-forecast and expected gas prices compressing margins
- Further recourse to equity markets for financing maximising early-phase dilution

Catalysts

- Successful completion and commissioning of CNG Project as proof of concept and initiation of cash-flow generation
- Next phase drilling at Rolleston West to maximise CNG capacity
- Progress on pipeline options – planning for bigger things

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FINANCIAL SERVICES GUIDE

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Effective Date: 6th May 2021

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